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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 51

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

UNION PACIFIC RAILROAD COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

FILED OCTOBER 8, 1934

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1934

No. 51

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

UNION PACIFIC RAILROAD COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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Docket Entries, No. 35,639.

1

UNION PACIFIC RAILROAD COMPANY, Petitioner, vs. COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket No. 35639.

APPEARANCES:

For Petitioner: HENRY W. CLARK, ESQ., HARRY J. GERRITY, ESQ.

2

For Respondent: E. C. ALGIRE, ESQ.

1928

Feb. 25—Petition received and filed. Taxpayer notified. (Fee paid.) (See Docket 35627.)

" 27—Copy of petition served on General Counsel.

Apr. 27—Answer filed by General Counsel.

" 30—Copy of answer served on taxpayer—General Calendar.

3

1931

Mar. 16—Hearing set May 6, 1931.

Apr. 6—Motion for continuance to Oct. 21, 1931, filed by taxpayer. April 8, 1931, granted.

" 6—Notice of appearance of Harry J. Gerrity as attorney for the taxpayer filed.

June 9—Motion to consolidate with dockets 35640 to 35649, and 35685, 35684, 40002 and 40060 to 40062 filed by taxpayer. June 11, 1931, granted.

July 24—Motion for leave to file amended petition filed by taxpayer—amended petition tendered.

4 *Docket Entries, No. 35,639.*

July 28—Motion for leave to file amended petition granted.

" 29—Copy of motion and amended petition served on General Counsel.

Aug. 31—Motion for continuance to December 2, 1931, filed by General Counsel. October 3, 1931, granted to December 7, 1931.

Sept. 28—Answer to amended petition filed by General Counsel.

5 Oct. 20—Application for order to take depositions filed by taxpayer.

" 26—Objection to issuance of an order to take depositions filed by General Counsel.

" 28—Motion to withdraw application filed by taxpayer. October 28, 1931, granted.

Nov. 9—Reply to answer filed by taxpayer. November 10, 1931, copy served.

" 24—Notice of change of hearing to December 2, 1931.

Dec. 2—Hearing had before Mr. Arundell on
6 merits. Dockets 35639-40-41-42-43-44-45-46-47-48-49, 35684-5, 40002, 40060-61-62 consolidated. Respondent's answer amended to amended petition to be filed. Interstate Commerce Commission reports filed. Stipulation read into record. Petitioner's brief due January 15, 1932; petitioner's reply March 1, 1932, and respondent's brief due February 15, 1932.

" 14—Transcript of hearing of December 2, 1931, filed.

" 18—Amendment to answer to amended petition filed by General Counsel.

Docket Entries, No. 35,639. 7

1932

Jan. 6—Stipulation of facts filed.
" 6—Stipulation as to schedules filed.
" 15—Brief and proposed findings filed by taxpayer.
" 16—Copy of brief and proposed findings served on General Counsel.
Feb. 8—Motion for extension to March 1, 1932, to file brief filed by General Counsel.
" 11—Order extending time to March 1, 1932, for respondent's brief and to March 15, 1932, for petitioner's reply entered. 8
" 29—Brief filed by General Counsel.
Mar. 14—Motion for extension to March 16, 1932, to file brief filed by taxpayer. March 15, 1932, granted.
" 16—Reply brief filed by taxpayer. March 17, 1932, copy served on General Counsel.
Apr. 14—Memorandum filed by General Counsel.
" 19—Memorandum filed by taxpayer.
Oct. 7—Opinion rendered—Mr. C. Rogers Arundell. Judgment will be entered under Rule 50. 9
" 24—Motion for review by full Board filed by taxpayer. October 25, 1932, denied.
Dec. 2—Agreed notice of settlement filed by taxpayer.
" 3—Decision entered—C. Rogers Arundell, Division 7.

1933

Jan. 21—Supersedeas bond in the amount of $12,000.00 approved and ordered filed.

Jan. 21—Petition for review by United States Circuit Court of Appeals, Second, with assignments of error filed by taxpayer.
" 21—Proof of service filed.
" 27—Praecipe filed.
" 27—Proof of service filed.
" 27—Statement of evidence lodged.
" 27—Notice of hearing on February 8, 1933, to approve statement filed.
11 " 31—Statement of evidence approved and ordered filed.
Feb. 24—Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by General Counsel.
Mar. 2—Proof of service filed by General Counsel (3).

Docket Entries, No. 40,060.

12

UNION PACIFIC RAILROAD COMPANY, Petitioner, vs. COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket No. 40060.

APPEARANCES:

For Petitioner: HENRY W. CLARK, ESQ., HARRY J. GERRITY, ESQ.

For Respondent: E. C. ALGIRE, ESQ.

1928

Aug. 2—Petition received and filed. Taxpayer notified.

" 3—Copy of petition served on General Counsel.

Sept. 17—Answer filed by General Counsel.

" 18—Copy served on taxpayer—General Calendar.

1931

Mar. 16—Hearing set May 6, 1931.

Apr. 6—Motion for continuance to October 21, 1931, filed by taxpayer. April 8, 1931, granted. 14

" 6—Notice of appearance of Harry J. Gerrity as attorney for the taxpayer filed.

June 9—Motion to consolidate with dockets 35639 to 35649, 35684-85, 40061 and 40062 filed by taxpayer. June 11, 1931, granted.

July 24—Motion for leave to file amended petition filed by taxpayer—amended petition tendered.

" 28—Motion for leave to file amended petition granted. 15

" 29—Copy of motion and amended petition served on General Counsel.

Aug. 31—Motion for continuance to December 2, 1931, filed by General Counsel. September 3, 1931, granted to December 7, 1931.

Sept. 28—Answer to amended petition filed by General Counsel.

Oct. 20—Application for order to take depositions filed by taxpayer.

" 26—Objection to issuance of an order to take depositions filed by General Counsel.

Oct. 28—Motion to withdraw application filed by taxpayer. October 28, 1931, granted.

Nov. 25—Notice of change of hearing to December 2, 1931.

Dec. 2—Hearing had before Mr. Arundell on the merits. Interstate Commerce Report filed. Stipulation read into record. Taxpayer's brief due January 15, 1932; Commissioner's brief due February 15, 1932. Reply brief due March 1, 1932.

17 " 14—Transcript of hearing of December 2, 1931, filed.

" 18—Amendment to answer to amended petition filed by General Counsel.

1932

Jan. 15—Brief and proposed findings filed by taxpayer.

" 16—Copy of brief and proposed findings served on General Counsel.

Feb. 8—Motion for extension to March 1, 1932, to file brief filed by General Counsel.

18 " 11—Order extending time to March 1, 1932, for respondent's brief and to March 15, 1932, for petitioner's reply entered.

" 29—Brief filed by General Counsel.

Mar. 14—Motion for extension to March 16, 1932, to file brief filed by taxpayer. March 15, 1932, granted.

" 16—Reply brief filed by taxpayer. March 17, 1932, copy served on General Counsel.

Apr. 16—Memorandum filed by General Counsel.

Oct. 7—Opinion rendered—C. Rogers Arundell, Division 7. Decision will be entered under Rule 50.

" 24—Motion for review by full Board filed by taxpayer. October 25, 1932, denied.

Dec. 2—Agreed notice of settlement filed by taxpayer.

" 3—Decision entered—C. Rogers Arundell, Division 7.

1933

Jan. 21—Supersedeas bond in the amount of $12,000.00 approved and ordered filed. 20

" 21—Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by taxpayer.

" 21—Proof of service filed.

" 27—Praecipe filed.

" 27—Proof of service filed.

" 27—Statement of evidence lodged.

" 27—Notice of hearing on February 8, 1933, to approve statement filed.

" 31—Statement of evidence approved and ordered filed. 21

Feb. 24—Petition for review by United States Circuit Court of Appeals, Second Circuit, with assignments of error filed by General Counsel.

Mar. 2—Proof or service filed by General Counsel (3).

22

Amended Petition, No. 35,639.

UNITED STATES BOARD OF TAX APPEALS.

UNION PACIFIC RAILROAD COMPANY, OREGON SHORT LINE RAILROAD COMPANY, THE ST. JOSEPH AND GRAND ISLAND RAILWAY COMPANY, SAN FRANCISCO AND PORTLAND STEAMSHIP COMPANY, by OREGON-WASHINGTON RAILROAD & NAVIGATION COMPANY, successor, YAKIMA VALLEY TRANSPORTATION COMPANY, THE UNION PACIFIC COAL COMPANY, WASHINGTON UNION COAL COMPANY, OREGON AND WASHINGTON RAILROAD COMPANY, THE RATTLESNAKE CREEK WATER COMPANY, UNION PACIFIC WATER COMPANY, UNION PACIFIC EQUIPMENT ASSOCIATION, GREEN RIVER WATER WORKS COMPANY, PORTLAND TERMINAL INVESTMENT COMPANY, Petitioners, against COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket Number 35639.

23

24

The above named UNION PACIFIC RAILROAD COMPANY, OREGON SHORT LINE RAILROAD COM-

PANY, THE ST. JOSEPH AND GRAND ISLAND RAILWAY COMPANY, SAN FRANCISCO AND PORTLAND STEAMSHIP COMPANY (BY OREGON-WASHINGTON RAILROAD & NAVIGATION COMPANY, successor), YAKIMA VALLEY TRANSPORTATION COMPANY, THE UNION PACIFIC COAL COMPANY, WASHINGTON UNION COAL COMPANY, OREGON AND WASHINGTON RAILROAD COMPANY, THE RATTLESNAKE CREEK WATER COMPANY, UNION PACIFIC WATER COMPANY, UNION PACIFIC EQUIPMENT ASSOCIATION, GREEN RIVER WATER WORKS COMPANY AND PORTLAND TERMINAL INVESTMENT COMPANY, in amendment of their original petition herein filed on February 25, 1928, hereby petition this Board for a redetermination of the deficiencies of income tax liability for the year 1920, 1921 and 1922 found by the Commissioner of Internal Revenue, respondent, in his notices of deficiency addressed to them, respectively (IT:CR:RR:60D—JFK), dated December 29, 1927; and as the basis of this proceeding allege as follows:

I.

PETITIONER'S INCORPORATION.

The petitioners herein were in 1920, and still are, corporations of the following states: Union Pacific Railroad Company, Oregon Short Line Railroad Company, San Francisco and Portland Steamship Company, and Union Pacific Equipment Association, of the State of Utah; Oregon-Washington Railroad & Navigation Company, Oregon and Washington Railroad Company and Portland Terminal Investment Company, of the State of Oregon; The St. Joseph and Grand

Island Railway Company, of the States of Nebraska and Kansas; Yakima Valley Transportation Company and Washington Union Coal Company, of the State of Washington; The Union Pacific Coal Company, The Rattlesnake Creek Water Company, Union Pacific Water Company and Green River Water Works Company, of the State of Wyoming; except that said San Francisco and Portland Steamship Company was dissolved in 1926.

Petition Union Pacific Railroad Company has its office at No. 120 Broadway, New York City, New York, and the address of the other petitioners above named, for the purposes of these proceedings, is in the care of the Union Pacific Railroad Company at No. 120 Broadway, New York City,

II.

Deficiency Letters.

On the 29th day of December, 1927, respondent mailed to petitioner Union Pacific Railroad Company a letter dated on said day (a copy of which is hereto annexed, together with the statements accompanying the same as far as material to this proceeding, and marked Exhibit A), giving notice of his final determination that additional taxes are due from said petitioner for the years 1920, 1921 and 1922 under the Revenue Acts of 1918 and 1921 as set forth in said letter.

On the 29th day of December, 1927, respondent mailed to each of the other petitioners, respectively, a letter, dated on said day (copies of which are hereto annexed and marked Exhibits B to M), giving notice of his final determination that additional taxes are due from said peti-

tioners, respectively, for the years and in the amounts hereinafter stated, under the Revenue Acts of 1918 and 1921.

The several letters aforesaid, Exhibits A to M, are hereinafter collectively called the "deficiency letter".

III.

DEFICIENCIES FOUND.

The additional taxes found by the deficiency letter are income taxes for the calendar years 1920, 1921 and 1922 and are as follows: 32

1920.

Union Pacific R. R. Co.	$383,532.50
Oregon Short Line R. R. Co.	110,691.12
St. Joseph & Grand Island Ry. Co.	31,466.03
San Francisco & Portland S. S. Co.	3,220.25
Yakima Valley Transportation Co.	330.81
Union Pacific Coal Co.	20,225.19
Washington Union Coal Co.	797.06
Oregon & Washington R. R. Co.	139.06
Rattlesnake Creek Water Co.	291.69
Union Pacific Water Co.	221.04
Union Pacific Equipment Assn.	34.34
	$550,949.09

33

1921.

Union Pacific R. R. Co.	$ 92,111.48
Oregon Short Line R. R. Co.	9,726.24
Yakima Valley Transportation Co.	70.81
Union Pacific Coal Co.	46,950.85
Washington Union Coal Co.	18.61

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Oregon & Washington R. R. Co.	485.04
Union Pacific Water Co.	61.61
	$149,424.64

1922.

Union Pacific R. R. Co.	$815,199.50
Yakima Valley Transportation Co.	212.72
35 Union Pacific Coal Co.	4,027.75
Washington Union Coal Co.	742.93
Rattlesnake Creek Water Co.	276.20
Union Pacific Water Co.	337.09
Green River Water Works Co.	110.77
Portland Terminal Investment Co. ..	658.88
	$821,565.84

36 The entire amount of the deficiency for each of the years 1920, 1921 and 1922 is in controversy, and in addition petitioners claim to be entitled to refunds approximating the following:

For 1920	$ 57,000
For 1921	638,000
For 1922	110,000

IV.

Assignment of Errors.

Petitioners assert that in the redetermination of their tax liability for the years 1920, 1921 and

1922, as set forth in the deficiency letter, respondent has erred in the following particulars:

* * * * *

L. In refusing to allow the deduction for 1921 of losses on bonds of other companies exchanged by Union Pacific Railroad Company for bonds of the Los Angeles & Salt Lake Railroad Company under a contract with W. A. Clark.

* * * * *

P. In refusing to allow as deductions for 1920, 1921 and 1922 amortization of discount and commissions on bonds issued by Union Pacific Railroad Company and Oregon Short Line Railroad Company prior to 1913. 38

* * * * *

V.

Facts.

The facts upon which petitioners rely in support of the foregoing assignments of error are as follows:

39

General Allegations.

1. The petitioners were in each of the years 1920, 1921 and 1922 affiliated corporations within the meaning of Section 240 of the Revenue Acts of 1918 and 1921.

2. For the years 1920, 1921 and 1922 petitioner Union Pacific Railroad Company, as the parent company, made consolidated returns for itself and the petitioners, and for certain other corporations affiliated with it and with them, and the deficiencies found by respondent for each of said

40 years are computed upon the basis of said consolidated returns. The term "affiliated companies", as used in this petition, means said parent company and all the other corporations included in the consolidated return for the year in question, whether petitioners in that year or not.

3. The accounts of the petitioners and of all their affiliated companies were in the years 1920, 1921 and 1922 and theretofore kept upon the accrual basis.

41 4. In 1926 the San Francisco and Portland Steamship Company, theretofore a corporation of the State of Utah, one of the affiliated companies in the years 1920, 1921 and 1922, was dissolved by judicial decree and thereupon all its assets were surrendered to Oregon-Washington Railroad & Navigation Company, its sole stockholder, a corporation of the State of Oregon, another of the affiliated companies in each of said years, and said last named company thereupon assumed and agreed to pay all remaining debts and liabilities of said dissolved corporation.

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* * * * *
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L—Loss on Clark Trade—1921.

71. On April 27, 1921, Los Angeles & Salt Lake Railroad Company (hereinafter called the "Salt Lake Company") had outstanding an issue of First Mortgage 4 Per Cent. Bonds (hereinafter called the "Salt Lake Bonds"), one-half of which were owned by petitioner Oregon Short Line Railroad Company and the other half largely by one William A. Clark and members of his family.

72. By an agreement, dated April 27, 1921, between petitioner Union Pacific Railroad Company and said Clark said Union Pacific Railroad Company undertook and agreed to accept delivery from said Clark and said Clark agreed to deliver at least $25,000,000 face value, of said Salt Lake bonds in exchange for the following bonds to be delivered by said Union Pacific Railroad Company: (1) First and Refunding Mortgage 4 Per Cent. Bonds issued by the Oregon-Washington Railroad & Navigation Company (hereinafter called the "Navigation bonds"), one 44
of the affiliated companies, guaranteed by said Union Pacific Railroad Company, to a principal amount equal to 50 per cent. of the principal of the Salt Lake bonds so delivered to it; (2) First Refunding Mortgage 4 Per Cent. Bonds issued by the Southern Pacific Railroad Company to a principal amount equal to 30 per cent. of the principal of said Salt Lake bonds so delivered, and (3) San Francisco Terminal First Mortgage 4 Per Cent. Bonds issued by the Southern Pacific Company to a principal amount equal to 20 per cent. of the principal of the Salt Lake 45
bonds so delivered. The bonds described in Numbers (2) and (3) are hereinafter sometimes collectively called "Southern Pacific bonds".

73. By said agreement the Union Pacific Railroad Company also undertook to accept delivery of any and all additional Salt Lake bonds, and to make exchange therefor upon the same terms, whether tendered by said Clark or by other holders.

74. It was provided by said agreement also that, since said First Refunding Mortgage Bonds

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of the Southern Pacific Railroad Company were not issued in denominations of less than $500, face value, a cash adjustment would be made by petitioner Union Pacific Railroad Company for and in lieu of amounts of said bonds less than $500, face value, which would otherwise be deliverable upon exchanges made under said agreement.

75. Pursuant to said agreement petitioner
47 Union Pacific Railroad Company during 1921 delivered, in exchange for Salt Lake bonds, to the holders thereof $8,815,500, face value, of Southern Pacific Railroad Company's First Refunding Mortgage Bonds, $5,894,000, face value, of Southern Pacific Company's San Francisco Terminal First Mortgage Bonds and $14,735,000, face value, of Navigation bonds, and paid in cash in adjustment of undeliverable fractions of Southern Pacific Railroad Company's First Refunding Mortgage Bonds $23,630.14, receiving therefor $29,470,000, face value, of Salt Lake
48 bonds.

76. Said Salt Lake bonds at and before the time of their acquisition by petitioner Union Pacific Railroad Company upon the exchanges aforesaid had a readily realizable market value; and the fair market value of said Salt Lake bonds on April 27, 1921, and at the times of their acquisition by said petitioner upon the exchanges aforesaid during 1921 was not in excess of 72.15 per cent. of their face value.

77. The Southern Pacific bonds delivered in exchange for said Salt Lake bonds had been

49

acquired by said Union Pacific Railroad Company at an average cost of 91.47 per cent. of face value for the Southern Pacific Railroad Company First Refunding Mortgage Bonds and 87.50 per cent. of face value for the Southern Pacific Company San Francisco Terminal First Mortgage Bonds, and to the extent that they were acquired prior to March 1, 1913, their actual cost was less than the market values of said bonds on March 1, 1913.

50

78. Said Salt Lake bonds were not acquired by said Union Pacific Railroad Company as an investment, but as a means of acquiring the half interest in the Salt Lake R. R. theretofore owned by said Clark and so securing operating control of the railroads of that company. The primary purpose of said contract of April 27, 1921, was the sale by said Clark to said Union Pacific Railroad Company of 125,000 shares of the capital stock of said Salt Lake Company, constituting the half of its entire stock, owned by him or his associates and family, and being

51

all of the stock of said Company not already owned by petitioner Oregon Short Line Railroad Company. Said Clark was not willing to dispose of his stock interest in the said Salt Lake Company without disposing of his holding of the bonds of said company and made it also a condition of said contract that other holders of said bonds should have the privilege of disposing of their bonds upon the same terms.

79. The Navigation bonds delivered by Union Pacific Railroad Company in exchange for Salt Lake bonds as aforesaid had been acquired by

Union Pacific Railroad Company in 1914 from the Oregon Short Line Railroad Company at 90 per cent. of their face value; and said Navigation bonds were not acquired or held by said Union Pacific Railroad Company as an investment, but were held primarily for the purpose of sale to the public to finance capital requirements of said petitioner and its affiliated companies.

80. There were outstanding in the hands of the public a large amount of said Southern Pacific bonds and Navigation bonds, additional to the bonds of those issues delivered as aforesaid by said Union Pacific Railroad Company to said Clark, and of the same issues as the bonds so delivered by it, and all of said issues were dealt in extensively on the New York Stock Exchange and had readily ascertainable market values. The market values of said bonds on the New York Stock Exchange on April 27, 1921, were: 75½ for said Southern Pacific Railroad Company First Refunding Mortgage Bonds, 71¼ for said Southern Pacific Company San Francisco Terminal First Mortgage Bonds and 70½ for said Navigation bonds.

81. Petitioner Union Pacific Railroad Company suffered losses upon the Southern Pacific bonds and Navigation bonds delivered by it to said Clark and others in exchange for Salt Lake bonds in 1921 as follows:

Delivered:

$8,815,500,	face value, Southern Pacific R. R. Co. 1st Refunding Mortgage Bonds, cost at 91.47	$8,063,537.85

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$5,894,000, face value, Southern Pacific Co. San Francisco Terminal First Mortgage Bonds, cost at 87.50		5,157,250.00
$14,735,000, face value, Navigation Bonds, cost at 90		13,261,500.00
Total cost		$26,482,287.85
Received:		
$29,470,000, face value, Salt Lake Bonds, worth at 72.15	$21,262,605.00	56
Less:		
Cash adjustment	23,630.14	
		21,238,974.86
Loss		$5,243,312.99

82. In the redetermination of the consolidated tax liability for 1921 respondent has refused to allow the aforesaid losses as deductions from the consolidated gross income. 57

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* * * * *
* * * * *

P—Prior-to-1913 Bond Discount—1920, 1921, 1922.

Convertible Bonds:

99. In 1907 petitioner Union Pacific Railroad Company made an issue of its corporate bonds designated as its 20-Year Convertible 4 Per Cent. Bonds, maturing July 1, 1927, and offered the same to its stockholders for *pro rata* subscription on July 10, 1907, at the subscription price of 90.

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100. In order to insure the sale of said bonds, a firm of bankers at the request of said petitioner formed an underwriting syndicate which guaranteed the sale of said bonds at the price at which they were to be offered to stockholders, said petitioner undertaking to pay a commission of two per cent. to said syndicate and a commission of one-half of one per cent. to said bankers as syndicate managers, computed upon the total amount of said bonds so offered.

59 101. The stockholders of said petitioner failed to exercise their subscription rights, except as to a comparatively small amount of said bonds, and said syndicate was required to purchase under its guaranty most of said issue, paying therefor the subscription price of 90 less their commission of 2 per cent.

102. Prior to January 1, 1920, said Convertible bonds had been reduced by conversions thereof into stock to the amount of $26,835,225, which amount was outstanding throughout the years
60 1920, 1921 and 1922, on which the difference of 12 per cent. (hereinafter called "discount") between the face value of said bonds and the price paid therefor by said syndicate was $3,220,227 and the banker's commission of one-half of one per cent. was $134,176.

103. Amortizing the aforesaid discount and commissions on said Convertible bonds over the 20 year life of said bonds gives the amount of $161,011.35 as the yearly amortization of said discount and $6,708.80 as the yearly amortization of said bankers commission.

104. No part of the aforesaid yearly amortization of discount and commissions on said Convertible bonds has been allowed as a deduction by the deficiency letter for any of the years under review.

First Lien & Refunding Bonds:

105. In 1908 petitioner Union Pacific Railroad Company made an issue of its corporate bonds designated as its First Lien & Refunding 4 Per Cent. Bonds, maturing June 1, 2008, and in June of that year $30,000,000, face value, and £4,000,000, face value, thereof were sold to the public by a firm of bankers for the account of said petitioner at the price of 95½, said bankers receiving a commission of 2½ per cent. 62

106. The discount suffered upon said $30,000,000, face value, and £4,000,000, face value, of First Lien & Refunding Bonds amounted to $2,185,878.88 and said bankers commission to $1,214,377.16, which amortized over the 100 year life of said bonds gives the amount of $21,858.78 as the yearly amortization of said discount and $12,143.77 as the yearly amortization of said commissions. 63

107. Petitioner Union Pacific Railroad Company in June, 1909, sold additional of its First Lien & Refunding bonds to petitioner Oregon Short Line Railroad Company, to the amount of $6,402,000, face value, at the price of 98 and to the amount of $2,000,000, face value, at the price of 97½, and said bonds were during the following year resold by said Oregon Short Line Rail-

road Company to bankers in part at the same price and in part at a lower price.

108. The discount upon the $8,402,000, face value, of bonds sold to Oregon Short Line Railroad Company as aforesaid was $178,040 which amortized over the 99 years of the remaining life of said bonds gives the amount of $1,798.38 as the yearly amortization of said discount.

65 109. In September, 1910, petitioner Union Pacific Railroad Company sold to bankers additional of its said First Lien & Refunding Bonds to the amount of £1,000,000, face value, at the price of 93 and to the amount of £500,000, face value, at the price of 95, and said sales to bankers were absolute sales and involved no commissions.

110. The discount suffered upon the sale of said £1,500,000 of said bonds in September, 1910, amounted to $440,397.50, which amortized over
66 the 98 years of the remaining life of said bonds gives the amount of $4,493.85 as the yearly amortization of said discount.

111. All the First Lien & Refunding bonds sold as aforesaid were outstanding in the hands of the public throughout the years under review, but of the aggregate of $28,151.01 of yearly amortization of discount and $12,143.77 of yearly amortization of commissions upon the aforesaid sales of First Lien and Refunding Bonds only $22,865.81 of discount amortization has been allowed by the deficiency letter as a deduction in each of the years under review.

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O. S. L. Refunding Bonds:

112. In October, 1904, petitioner Oregon Short Line Railroad Company called for redemption, effective February 1, 1905, its issue of Participating 4 per cent. bonds of which $36,500,000, face value, were outstanding, and arranged to refund the same by making a new issue of its Refunding 4 Per cent. bonds, maturing December 1, 1929.

113. At the request of said petitioner a firm of 68
bankers formed a syndicate which guaranteed the sale of $40,000,000, face value, of said Refunding bonds at the price of 96, subject to an offer to the holders of Participating Bonds of a right to subscribe for said Refunding bonds, at the price of 96 and to receive in cash the difference between that price and the redemption price of their Participating bonds.

114. Said petitioner agreed to pay said syndicate a commission of 2 per cent. and said bankers as syndicate managers a commission of 1 per 69
cent., upon the face value of said Refunding bonds so underwritten.

115. Said bankers published in October, 1904, in their own names, the offer aforesaid to holders of Participating bonds, and somewhat less than $28,000,000, face value, of said Refunding bonds were subscribed for by the holders of Participating bonds, pursuant to said offer.

116. The balance of said issue of Refunding bonds, at least $12,000,000, face value, was taken by said syndicate pursuant to its guaranty, pay-

70 ing therefor the price of 96 less its commission of 2 per cent.

117. The discount of 4 per cent. upon the $28,000,000 of said Refunding bonds taken by the Participating bondholders amounted to $1,-120,000; the difference of 6 per cent. (hereinafter also called "discount") between the price paid for said $12,000,000 of Refunding bonds by the syndicate and the face value thereof amounted to $720,000; and the 2 per cent. commission of
71 the syndicate upon the $28,000,000 of said bonds taken by the Participating bondholders and the 1 per cent. commission of the bankers upon the entire $40,000,000 of bonds together amounted to $960,000.

118. Amortizing over the 25 year life of said Refunding bonds the aforesaid discount and commissions, respectively, gives the amount of $73,-600 as the yearly amortization of said discount and $38,400 as the yearly amortization of said commissions.

72 119. In June, 1905, said Oregon Short Line Railroad Company sold to petitioner Union Pacific Railroad Company additional of said Refunding bonds to the amount of $5,0000,000, face value, at the price of 94, which said Union Pacific Railroad Company within the following year resold to bankers.

120. The discount on the $5,000,000 of said bonds sold to Union Pacific Railroad Company as aforesaid was $300,000, which amortized over the 25 year life of said bonds gives the amount of $12,000 as the yearly amortization of said discount.

121. All of said $45,000,000 of Refunding bonds were outstanding in the hands of the public throughout the years under review; but no part of the $124,000 of yearly amortization of the aforesaid discount and commissions has been allowed by the deficiency letter as a deduction in any of said years.

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VI. 74

RELIEF PRAYED.

Petitioners pray that their income tax liability for 1920, 1921 and 1922 be redetermined by the Board and that over payments be found for each of said years, resulting from relief upon the several errors herein assigned and the facts pleaded in support thereof, viz.:

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75

WHEREFORE, petitioners pray that this Board hear and determine their tax liabilities upon the issues herein set forth.

Dated: July 23, 1931.

HENRY W. CLARK,
120 Broadway, New York, N. Y.

HARRY J. GERRITY,
Hill Building, Washington, D. C.,
Counsel for Petitioners.

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76 **Answer to Amended Petition, No. 35,639.**

(Filed Sept. 28, 1931.)

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Docket Number 35639.

Comes now the Commissioner of Internal Revenue, through his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and for answer to the amended petition of this taxpayer admits and denies as follows:

I.

77 Admits the allegations contained in Part I of the amended petition.

II.

Admits the allegations contained in the first paragraph of Part II of the amended petition except that it is denied that Exhibit A is a copy of the deficiency letter so far as material to this proceeding.

Admits the allegations contained in the second and third paragraphs of Part II of the amended
78 petition.

III.

Admits the allegations contained in Part III of the amended petition except that it is denied that the amounts of taxes in controversy for the respective years is correctly stated therein.

IV.

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K to P, inclusive. Denies that error was committed as alleged in subdivisions K to P, inclusive, of Part IV of the amended petition.

79

V.

GENERAL ALLEGATIONS.

1, 2, 3, and 4. Admits the allegations contained in paragraphs 1, 2, 3, and 4 under this heading of Part V of the amended petition.

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L—Loss on Clark Trade—1921.

71. Admits the allegations contained in paragraph 71 under this heading of Part V of the amended petition. 80

72, 73, and 74. Denies the allegations contained in paragraphs 72, 73, and 74 under this heading of Part V of the amended petition for the reason that the agreement referred to is the best evidence of the provisions thereof.

75 and 76. Admits the allegations contained in paragraphs 75 and 76 under this heading of Part V of the amended petition.

77. Admits the allegations contained in paragraph 77 under this heading of Part V of the amended petition except, for lack of information necessary to form a belief as to the truth or falsity thereof, it is denied that to the extent Southern Pacific Railroad Company First Refunding Mortgage Bonds and Southern Pacific Company San Francisco Terminal First Mortgage Bonds were acquired prior to March 1, 1913, their actual cost was less than the market, values of said bonds on March 1, 1913. 81

78. Denies the allegations contained in paragraph 78 under this heading of part V of the amended petition.

82 *Answer to Amended Petition, No. 35,639.*

79. Admits that the Navigation Bonds delivered by the Union Pacific Railroad Company in exchange for Salt Lake Bonds had been acquired by the Union Pacific Railroad Company in 1914, from the Oregon Short Line Railroad Company at 90 per cent. of the face value as alleged in paragraph 79 under this heading of Part V of the amended petition, but denies that the Navigation Bonds were not acquired or held by said Union Pacific Railroad Company as an
83 investment, and denies that they were held primarily for the purpose of sale to the public to finance capital requirements as alleged.

80. Admits the allegations contained in paragraph 80 under this heading of Part V of the amended petition.

81. Denies the allegations contained in paragraph 81 under this heading of Part V of the amended petition.

82. Admits the allegations contained in paragraph 82 under this heading of Part V of the
84 amended petition.

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P—Prior to 1913 Bond Discount—1920, 1921, 1922.

99 to 121, inclusive. Admits the allegations contained in paragraphs 99 to 121, inclusive, under this heading of Part V of the amended petition.

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Amended Petition, No. 40,060. 85

WHEREFORE, it is prayed that the appeal be denied except in so far as error is conceded herein, or if the rental interest is legally considered as constituting taxable income for the Federal control period, the alternative relief herein requested be granted as to that issue and that the affirmative relief herein requested be granted.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

of Counsel: 86

E. C. ALGIRE,
Special Attorney,
Bureau of Internal Revenue.

ECA:RBI

Amended Petition, No. 40,060.

(Filed July 28, 1931.)

UNITED STATES BOARD OF TAX APPEALS. 87

UNION PACIFIC RAILROAD COMPANY, LOS ANGELES & SALT LAKE RAILROAD COMPANY, DES CHUTES RAILROAD COMPANY, Petitioners, vs. COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket No. 40,060.

The above-named UNION PACIFIC RAILROAD COMPANY, LOS ANGELES & SALT LAKE RAILROAD COMPANY and DES CHUTES RAILROAD COMPANY,

88 *Amended Petition, No. 40,060.*

petitioners, hereby petition, in amendment of their original petition filed herein on August 2, 1928, for a redetermination of their income tax liability and of the deficiencies found by the Commissioner of Internal Revenue, respondent, in his deficiency letters addressed to them, respectively (IT:AR:RR—60D:MB), dated June 6, 1928.

I.

PETITIONERS.

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The petitioners herein were in 1923 and still are corporations of the following States: Union Pacific Railroad Company and Los Angeles & Salt Lake Railroad Company, of the State of Utah; Des Chutes Railroad Company, of the State of Oregon.

Petitioner Union Pacific Railroad Company has its office at No. 120 Broadway, New York City, New York, and the address of the other petitioners above-named, for the purposes of this proceeding, is in the care of Union Pacific
90 Railroad Company at No. 120 Broadway, New York City, New York.

II.

DEFICIENCY LETTERS.

On the 6th day of June, 1928, respondent mailed to petitioner Union Pacific Railroad Company a letter, dated on said day (a copy of which is hereto annexed, together with the supporting statements which accompanied it, as far as they are material to this proceeding, and marked Exhibit A) giving notice of his final

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determination that additional taxes are due from said petitioner for the year 1923.

On the 6th day of June, 1928, respondent mailed to petitioner Los Angeles & Salt Lake Railroad Company a letter, dated on said day (a copy of which is hereto annexed and marked Exhibit Y), giving notice of his final determination that additional taxes are due from said petitioner for the year 1923.

On the 6th day of June, 1928, respondent mailed to petitioner Des Chutes Railroad Company a letter, dated on said day (a copy of which 92
is hereto annexed and marked Exhibit Z), giving notice of his final determination that additional taxes are due from said petitioner for the year 1923.

Said letters, Exhibits A (with its accompanying statements), Y and Z, are hereinafter collectively called the "deficiency letter".

III.

DEFICIENCIES FOUND.

93

The additional taxes proposed by the deficiency letter to be assessed are income taxes for the calendar year 1923 and are as follows:

Union Pacific Railroad Company	$42,313.87
Los Angeles & Salt Lake Railroad Company	53,028.76
Des Chutes Railroad Company	140.80
Total	$95,483.43

The entire amount of the proposed deficiencies is in controversy and in addition petitioner Union Pacific Railroad Company claims to be

94 *Amended Petition, No. 40,060.*

entitled to a refund for the consolidated group of $79,653.25.

IV.

ASSIGNMENT OF ERRORS.

Petitioners assert that in the redetermination of their income tax liability for the year 1923, as set forth in the deficiency letter, respondent has erred in the following particulars:

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95 H. In refusing to allow the deduction of the annual amortization of discount and commissions on bonds issued prior to 1913.

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V.

FACTS.

The facts upon which petitioners rely in support of the foregoing assignments of error are
96 as follows:

1. The petitioners were throughout the year 1923 affiliated companies within the meaning of Section 240 of the Revenue Act of 1921.

2. For the year 1923 petitioner Union Pacific Railroad Company, as the parent company, made a consolidated return for itself and the other petitioners herein named and for certain other corporations affiliated with it and with them, and the deficiencies found by respondent as hereinbefore alleged are computed upon the basis of said consolidated return. The term "affiliated companies" as used in this petition means said

parent company and all the other corporations included in said consolidated return, whether petitioners herein or not.

3. The accounts of the petitioners and of all other affiliated companies were for the year 1923 and theretofore kept upon the accrual basis.

4. On the 18th day of September, 1925, and the 12th day of March, 1928, petitioner Union Pacific Railroad Company filed claims for refund of $72,487.01 and $142,619.58, respectively, of the consolidated tax paid by it for the year 1923 for itself and its affiliated companies. 98

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H—Prior-to-1913 Bond Discount.

Convertible Bonds:

42. In 1907 petitioner Union Pacific Railroad Company made an issue of its corporate bonds designated as its 20-Year Convertible 4 Per cent. Bonds, maturing July 1, 1927, and offered the same to its stockholders for *pro rata* subscription on July 10, 1907, at the subscription price of 90, the subscription rights so offered aggregating $73,762,000. of bonds. 99

43. In order to insure the sale of said bonds, a firm of bankers at the request of said petitioner formed an underwriting syndicate which guaranteed the sale of said bonds at the price at which they were to be offered to stockholders, said petitioner undertaking to pay a commission of two per cent. to said syndicate and a commission of one-half of one per cent. to said bankers as

100 *Amended Petition, No. 40,060.*

syndicate managers, computed upon the total amount of said bonds so offered.

44. The stockholders of said petitioner failed to exercise their subscription rights, except as to a comparatively small amount of said bonds, and said syndicate was required to purchase under its guaranty most of said issue, paying therefor the subscription price of 90 less its commission of 2 per cent.

101 45. Prior to January 1, 1923, said Convertible bonds had been reduced by conversions thereof into stock to the amount of $26,835.225, which amount was outstanding throughout the year 1923, on which the difference of 12 per cent. (hereinafter called "discount") between the face value of said bonds and the price paid therefor by said syndicate was $3,220,227 and the bankers' commission of one-half of one per cent. was $134,176.

102 46. Amortizing the aforesaid discount and commissions on said Convertible bonds over the 20 year life of said bonds gives $161,011.35 as the yearly amortization of said discount, and $6,708.80 as the yearly amortization of said bankers' commission, no part of which amortization of discount and commissions on said Convertible bonds has been allowed as a deduction by the deficiency letter.

First Lien & Refunding Bonds:

47. In 1908 petitioner Union Pacific Railroad Company made an issue of its corporate bonds designated as its First Lien & Refunding 4 Per

cent. Bonds, maturing June 1, 2008, and in June of that year $30,000,000, face value, and £4,000,000, face value, thereof, were sold to the public by a firm of bankers for the account of said petitioner at the price of 95½, said bankers receiving a commission of 2½ per cent.

48. The discount suffered upon said $30,000,000, face value, and £4,000,000, face value, of First Lien & Refunding Bonds amounted to $2,185,878.88 and said bankers' commission to $1,214,377.16, which amortized over the 100 year 104
life of said bonds give $21,858.78 as the yearly amortization of said discount and $12,143.77 as the yearly amortization of said commissions.

49. Petitioner Union Pacific Railroad Company in June, 1909, sold additional of its First Lien & Refunding bonds to petitioner Oregon Short Line Railroad Company, to the amount of $6,402,000, face value, at the price of 98, and to the amount of $2,000,000, face value, at the price of 97½, and said bonds were during the following year resold by said Oregon Short Line Rail- 105
road Company to bankers in part at the same price and in part at a lower price.

50. The discount upon the $8,402,000, face value, of said bonds sold to Oregon Short Line Railroad Company as aforesaid was $178,040, which amortized over the 99 years of the remaining life of said bonds gives $1,798.38 as the yearly amortization of said discount.

51. In September, 1910, petitioner Union Pacific Railroad Company sold to bankers additional of its said First Lien & Refunding bonds

to the amount of £1,000,000, face value, at the price of 93, and to the amount of £500,000, face value, at the price of 95, and said sales to bankers were absolute sales and involved no commissions.

52. The discount suffered upon the sale of said £1,500,000 of said bonds in September, 1910, amounted to $440,397.50, which amortized over the 98 years of the remaining life of said bonds
107 gives $4,493.85 as the yearly amortization of said discount.

53. All the First Lien & Refunding bonds sold as aforesaid were outstanding in the hands of the public throughout the year 1923, but of the aggregate of $28,151.01 of yearly amortization of discount and $12,143.77 of yearly amortization of commissions upon the aforesaid sales of First Lien & Refunding bonds only $22,865.81 of discount amortization has been allowed by the deficiency letter as a deduction in said year.

108 *O. S. L. Refunding Bonds:*

54. In October, 1904, Oregon Short Line Railroad Company, one of the affiliated companies, called for redemption, effective February 1, 1905, its issue of Participating 4 per cent. bonds of which $36,500,000, face value, were outstanding and arranged to refund the same by making a new issue of its Refunding 4 Per cent. bonds, maturing December 1, 1929.

55. At the request of said affiliated company a firm of bankers formed a syndicate which guaranteed the sale of $40,000,000, face value, of

said Refunding bonds at the price of 96, subject to an offer to the holders of Participating bonds of a right to subscribe for said Refunding bonds at the price of 96 and to receive in cash the difference between that price and the redemption price of their Participating bonds.

56. Said affiliated company agreed to pay said syndicate a commission of 2 per cent. and said bankers as syndicate managers a commission of 1 per cent., upon the face value of said Refunding bonds so underwritten. 110

57. Said bankers published in October, 1904, in their own names, the offer aforesaid to holders of Participating bonds, and somewhat less than $28,000,000, face value, of said Refunding bonds were subscribed for by the holders of Participating bonds, pursuant to said offer.

58. The balance of said issue of Refunding bonds, at least $12,000,000, face value, was taken by said syndicate, pursuant to its guaranty, paying therefor the price of 96 less its commission of 2 per cent. 111

59. The discount of 4 per cent. upon the $28,000,000 of said Refunding bonds taken by the Participating bondholders amounted to $1,120,000; the difference of 6 per cent. (hereinafter also called "discount") between the price paid for said $12,000,000 of Refunding bonds by the syndicate and the face value thereof amounted to $720,000; and the 2 per cent. commissions of the syndicate upon the $28,000,000 of said bonds taken by the Participating bondholders and the 1 per cent. commission of the bankers upon the entire $40,000,0000 of bonds together amounted to $960,000.

112 *Amended Petition, No. 40,060.*

60. Amortization over the 25 year life of said Refunding bonds the aforesaid discount and commissions, respectively, gives $73,600 as the yearly amortization of said discount and $38,400 as the yearly amortization of said commissions.

61. In June, 1905, said Oregon Short Line Railroad Company sold to petitioner Union Pacific Railroad Company additional of said Refunding bonds to the amount of $5,000,000, face
113 value, at the price of 94, which said Union Pacific Railroad Company within the following year resold to bankers.

62. The discount on the $5,000,000 of said bonds sold to Union Pacific Railroad Company as aforesaid was $300,000, which amortized over the 25 year life of said bonds gives $12,000 as the yearly amortization of said discount.

63. All of said $45,000,000 of Refunding bonds were outstanding in the hands of the public throughout the year 1923; but no part of the
114 $124,000 of yearly amortization of the aforesaid discount and commissions has been allowed by the deficiency letter as a deduction in said year.

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VI.

Relief Prayed.

Petitioners pray that their income tax liability for the year 1923 be redetermined by this

Board, and that the deficiencies proposed by the deficiency letter be reversed and an overpayment determined, resulting from relief upon the several errors herein assigned and the facts pleaded in support thereof, viz:

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* * * * *

WHEREFORE, petitioners pray that this Board hear and determine their tax liability upon the issues herein set forth.

Dated, July 23, 1931.

HENRY W. CLARK,
120 Broadway,
New York City, N. Y.,

HARRY J. GERRITY,
Hill Building,
Washington, D. C.,
Counsel for Petitioners.

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Answer to Amended Petition, No. 40,060.

(Filed September 28, 1931.)

Docket Number 40060.

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the amended petition filed by the above named petitioners, admits and denies as follows:

118 *Answer to Amended Petition, No. 40,060.*

I

Admits the allegations contained in Part I of the amended petition.

Admits the allegations contained in the first paragraph of Part II of the amended petition except that it is denied that Exhibit A is a copy of the deficiency letter so far as material to this proceeding.

Admits the allegations contained in the second, third, and fourth paragraph of Part II of the
119 amended petition.

III.

Admits the allegations contained in Part III of the amended petition except that it is denied that the taxes in controversy are correctly stated therein.

IV.

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E to H, inclusive. Denies that error was com-
120 mitted as alleged in paragraphs E to H, inclusive, of Part IV of the amended petition.

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V.

1, 2, 3 and 4. Admits the allegations contained in paragraphs 1, 2, 3 and 4 of Part V of the amended petition.

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* * * * *

Opinion.

121

H-Prior-to-1913 Bond Discount.

42 to 63, inclusive. Admits the allegations contained in paragraphs 42 to 63, inclusive, under this heading of Part V of the amended petition.

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WHEREFORE, it is prayed that the petitioners' appeal be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue. 122

Of Counsel:

E. C. ALGIRE,
Special Attorney,
Bureau of Internal Revenue.
ECA:RBI

Opinion.

Docket Nos. 35639 and 40060.

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123

Loss: Exchange of bonds for bonds: In 1921 the Union Pacific Railroad Company exchanged bonds of three other companies, which bonds it had acquired by purchase, for bonds of the Los Angeles & Salt Lake Railroad Company, the fair market value of which was less than the cost of the bonds given in exchange. *Held* that the exchange was one on which no gain or loss is recognized under Section 202 of the Revenue Act of 1921.

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124 *Opinion.*

Amortization of discount and commissions on bonds issued prior to 1913: Held that discount on bonds issued prior to 1913 may be amortized over the life of the bonds. Further *held*, that commissions paid on the sale of such bonds may not be amortized and no deduction therefor is allowable in the taxable years.

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125 OPINION.

ARUNDELL: These proceedings involve deficiencies in income taxes of the Union Pacific Railroad Company and its affiliated corporations for the years 1920 to 1923, inclusive, in an aggregate amount of $1,617,423. Docket No. 40002 is a transferee proceeding, which the parties agree is disposed of by their stipulation that any deficiency shall be allocated wholly to the parent, the Union Pacific Railroad Company. The transferee liability asserted by the respondent is in
126 the amount of $3,220.25.

The petitions filed allege twenty-five errors, of which fourteen, and an affirmative defense presented by respondent, have been disposed of by confession, abandonment, or stipulation. The matters so disposed of are set forth in petitioner's brief and are agreed to by respondent in his brief. They are incorporated herein by reference and will be given effect under Rule 50.

Most of the facts relating to the remaining eleven issues have been agreed upon through the medium of respondent's acquiescence in the findings proposed by petitioners. We will set out the several issues to be decided, numbered and

lettered as they appear in the pleadings and briefs, and under each one give only a summary of the facts sufficient for an understanding of the question presented.

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Issue L. Whether the Union Pacific Railroad Company sustained a deductible loss in 1921 through the exchange of bonds of other companies for bonds of the Los Angeles & Salt Lake Railroad Company under a contract with W. A. Clark. 128

Prior to the transaction hereinafter described the Union Pacific Railroad Company, hereinafter called Union Pacific, owned all the stock of the Oregon Short Line Railroad Company, hereinafter called Oregon Short Line. The latter company, Oregon Short Line, in turn owned (1) all the stock of the Oregon-Washington Railroad & Navigation Company, hereinafter called Navigation Company, and (2) one-half the stock and bonds of the Los Angeles & Salt Lake Railroad 129 Company, hereinafter called the Salt Lake Company. The remaining one-half of the stock and bonds of the Salt Lake Company were owned largely by W. A. Clark and members of his family. The total issue of Salt Lake stock was 250,000 shares, and the total outstanding issue of bonds, which were 4 per cent., first mortgage bonds, amounted to something over $58,000,000 face value.

Under date of April 27, 1921, the Union Pacific and Clark entered into an agreement by which the Union Pacific agreed to buy the 125,000 shares of Salt Lake Company stock then owned by Clark and his family at $20 a share.

By the same agreement the Union Pacific agreed to accept delivery from Clark, and Clark agreed to deliver at least $25,000,000 face value of Salt Lake Company bonds in exchange for the following bonds to be delivered by the Union Pacific: (1) Navigation Company first and refunding mortgage 4 per cent. bonds, guaranteed by the Union Pacific, to a principal amount equal to 50 per cent. of the principal of the Salt Lake bonds delivered; (2) Southern Pacific Railroad Company first refunding mortgage 4 per cent. bonds to a principal amount equal to 30 per cent. of the principal of the Salt Lake bonds delivered; (3) San Francisco Terminal first mortgage 4 per cent. bonds, issued by the Southern Pacific Company to a principal amount equal to 20 per cent. of the principal of the Salt Lake bonds delivered.

By the same agreement the Union Pacific also agreed to accept delivery of any and all additional Salt Lake bonds, and to make exchange therefore upon the same terms, whether tendered by Clark or by other holders. The agreement also provided for a cash adjustment by the Union Pacific in lieu of undeliverable fractions of the Southern Pacific bonds called for upon the exchanges.

Pursuant to the agreement, during 1921 bonds of the Salt Lake Company of the face value of $29,470,000 were delivered to the Union Pacific which gave in exchange therefor the following bonds:

	Face Value	*Cost to Union Pacific*
Navigation Company bonds	$14,735,000	$13,261,500.00
Southern Pacific Company bonds	8,815,500	8,063,537.85
San Francisco Terminal bonds	5,894,000	5,157,250.00

Some of the bonds delivered by the Union Pacific had been acquired by it prior to March 1, 1913, and as to such bonds cost was lower than fair market value at March 1, 1913. The Salt Lake bonds acquired by the Union Pacific in 1921 had a readily realizable value, and the fair market value at the time of acquisition by the Union Pacific was not in excess of 72.15 of their face value, or an aggregate value of $21,262,605.

The difference between the cost to the Union Pacific of the bonds delivered by it in exchange for the Salt Lake bonds in 1921, and the market value of the Salt Lake bonds received was as follows:

Delivered by Union Pacific:		
Navigation bonds (Cost)	$13,261,500.00	
Southern Pacific bonds (Cost)	8,063,537.85	
San Francisco Terminal bonds (Cost)	5,157,250.00	
Total cost		$26,482,287
Received by Union Pacific:		
Salt Lake bonds (Value)	$21,262,605.00	
Less cash adjustment	23,630.14	21,238,974
Difference		$ 5,243,312

The Navigation Company bonds exchanged for Salt Lake bonds in 1921, were acquired by the Union Pacific in 1914 in anticipation of legislation which was expected to impose restrictions on the issuance of securities, and the Union Pacific contemplated guaranteeing and selling them at some future time. After the bonds were acquired by the Union Pacific there was no satisfactory market for them in view of their low interest rate, and, as the company had other

resources, it continued to hold the bonds until the time of the exchange in 1921.

The Union Pacific had two objects in view in entering into the contract of April 27, 1921. One was to gain operating control of the Salt Lake railroad. As matters stood before the exchange in 1921, half of the Salt Lake Company directors were elected by the Clark interests and half by Union Pacific interests. Clark was president of the company. These two interests were har-
137 monious, but the Union Pacific deemed it advisable to secure sole control so as to have all operating matters and traffic arrangements exclusively under its direction, and also for the purpose of having its own entrance into southern California which it did not then have. The other object was to place the Union Pacific in better position for further financing when needed. The Union Pacific had no mileage available upon which to place first liens for new financing, and so it was considered advisable to acquire the Salt Lake bonds which could then
138 be cancelled and the mortgage discharged, and thus have available substantial mileage against which to issue new first mortgage bonds. The Union Pacific never contemplated selling the Salt Lake bonds, and it still holds them.

Petitioner Union Pacific contends that the difference between the cost of the bonds delivered by it in 1921 and the value of the Salt Lake bonds received by it in the exchange above described constituted a deductible loss in 1921. The parties are agreed upon the basic figures, but respondent contends that the exchange was one under which gain or loss is not recognized by the Revenue Act of 1921 and the Regulations issued thereunder.

The applicable section of the Revenue Act is Section 202, subsections (c) and (c)(1) as follows:

> For the purposes of this title, on an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recog- 140
> nized—
>
> When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale), is exchanged for property of a like kind or use.

Petitioner's contention is that the exchange was not an exchange of property held for investment or productive use in trade or business for property of a like kind or use, hence the loss sustained on the exchange is one that is recog- 141
nized by the Revenue Act.

In the argument the exchange is separated into two parts, first, the exchange of the Navigation Company bonds, and second, the exchange of the Southern Pacific and San Francisco Terminal bonds.

Petitioner argues that the Navigation Company bonds were held primarily for sale, hence they come within the exception in Section 202 (c)(1), and further that bonds of a wholly-owned subsidiary are not held by the parent as an investment or for productive use because the ownership of the stock insures to the parent

142 *Opinion.*

the realization of the net income of the subsidiary available for distribution. Under Section 202(c)(1) gain or loss is recognized on an exchange involving "stock-in-trade or other property held primarily for sale". We find considerable difficulty in accepting petitioner's view that the Navigation bonds were property held primarily for sale. The evidence is that the Union Pacific acquired the bonds originally in the hope of having them for sale free from the restriction
143 of the then anticipated legislation for the regulation of the issuance of securities. But from 1914 to 1921 the petitioner continued to own and hold the bonds. There is no evidence that it made any attempt to sell them. There is testimony that after they were acquired there was practically no market for 4 per cent. bonds. We should like more information than this. We are not informed to what extent the market for such bonds dropped. For all we know it might have been possible for the Union Pacific to have disposed of the bonds at a profit even though the
144 market for such bonds fell somewhat. Granting that the Navigaion bonds were acquired with the intent of ultimately selling them, it does not follow that they were not held in the meantime for investment. The two objectives are not inconsistent. Nor do we think that the ownership of all the stock of the subsidiary is determinative of whether the bonds were held as an investment. Had any of the bonds been held by outside interest the earnings available for distribution to the parent would have been reduced by the amount of interest on such bonds. Under the rule of "*ejusdem generis*" we construe the phrase "or other property" as including prop-

erty of the same general nature as stock-in-trade, that is, property acquired for sale and openly and continuously offered for sale to the public. Stocks or bonds might well be considered the stock in trade of a dealer in securities. But dealing in securities was not the business of petitioner in this case. The fact that it proposed at some time to dispose of the bonds, after enhancing their value by endorsement, in our opinion does not bring petitioner within the intent of the statute. The burden of proof is on petitioner to establish that the Navigation bonds 146
were not held for investment. *R. D. Davis,* 21 B. T. A. 1078, and it has not proven its case to our satisfaction.

The parties are agreed that the record does not show whether the Southern Pacific and San Francisco Terminal bonds were held by the Union Pacific for investment prior to the exchange in 1921, but petitioner assumes for the purpose of argument that they were so held. The petitioner further concedes that the bonds delivered and those received in the exchange 147
were property of "a like kind".

Inasmuch as the statute provides for nonrecognition of gain or loss "when property held for investment * * * is exchanged for property of like kind or use," it would seem that the concession of petitioner that the bonds exchanged were of like kind would bring the transaction within the statute. But the argument is advanced that in *Richard T. Greene, et al., Trustees,* 15 B. T. A. 401, affirmed 42 Fed. (2d) 852, and *Edson* v. *Lucas,* 40 Fed. (2d) 398, it was held that the phrase "property of a like kind or use" is not to be regarded as disjunctive

but as a conjunctive expression. Under this construction of the statute it would be necessary that the property received be of like kind *and* use to that delivered in order that gain or loss be not recognized. The *Greene* case decided by the Board does not so hold. The case involved an exchange of investment stock for Federal, State, municipal, and railway bonds which were thereafter held for investment, and we held that the phrase "or use" in the statute applies to
149 property held for investment as well as to property held for productive use in trade or business. It is true that the Circuit Court of Appeals for the Second Circuit when the case was before it on appeal stated that, "If of like 'kind' and 'use', no gain is to be recognized in the exchange under the statute." We think no one will disagree with that statement. But it is not a holding, as argued by petitioner, that the property must be of like kind *and* use to come within the non-recognition provisions. In the course of the opinion the phrase "like kind or
150 use" appears several times and nowhere is there any intimation that it is to be construed in the conjunctive. In *Edson* v. *Lucas, supra,* the Board's opinion in the *Greene* case is cited with approval and we find nothing in the opinion of the Court to sustain the view contended for by petitioner here.

No reason occurs to us, and none is suggested, why the conjunction "or" should not be construed in its ordinary sense, or wherein the purpose of the statute will be defeated by giving it such construction. As the bonds delivered and those received by the Union Pacific were admittedly of "like kind", we hold that under the

statute the respondent correctly refused to recognize any loss on the exchange.

Granting that some effect should be given to the words "or use" in the statute, we are still of the opinion that the exchange here was one on which no loss can be recognized. The bonds delivered by Union Pacific were held for investment. The Salt Lake bonds received by it were acquired, not for sale, but for the purpose of placing the Union Pacific in better position for future financing. It intended, through cancelation of the bonds and the underlying mortgage, to enhance the value of its property and thus make its future bond issues more attractive to the investing public. "To invest imports a laying out of money, or money's worth * * * by the concern itself in acquiring something of permanent use in the business". *La Belle Iron Works* v. *United States,* 256 U. S. 377. Here the Union Pacific by buying up the stock of the Salt Lake acquired operating control of the railroad, but that road was burdened with the outstanding mortgage and bonds and was of little value for financing purposes; by taking up the bonds the Union Pacific acquired it free from obligation, and this, its bankers advised it, would be most helpful in getting a good price for its bonds. Viewing the transaction in this way it seems to us that it can properly be said that the Salt Lake bonds were acquired for investment purposes in that the Union Pacific thereby acquired "something of permanent use in the business".

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The amendment to Section 202(c)(1) of the Revenue Act of 1921, made by the Act of March 4, 1923, was effective as of January 1, 1923, and

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Opinion.

does not affect the transaction here involved. *Florence G. Baldwin,* 23 B. T. A. 512.

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Issue P for 1920, 1921 and 1922; Issue H for 1923. Whether deductions are allowable for amortization of discounts and commissions on bonds issued by Union Pacific Railroad Company and Oregon Short Line Railroad Company prior to 1913.

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All of the findings of fact proposed by petitioners relating to these issues are agreed to by respondent, and we adopt them as our findings. For the purposes of this report it will be sufficient to say that prior to 1913 the two railroads sold several issues of bonds at varying rates of discount and in connection with the sales paid commissions to bankers. The railroads claim, and the respondent has refused to allow, deductions in the taxable years for the discounts and commissions amortized over the life of the bonds. The amounts claimed are summarized as follows:

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	Discount	*Commissions*
Convertible bonds	$161,011.35	$ 6,708.80
First lien and refunding bonds	5,285.20	12,143.77
Refunding bonds	85,600.00	38,400.00
Total annual deduction claimed	$251,896.55	$57,252.57

Counsel for respondent concedes that in *Chicago, Rock Island & Pacific Railroad Co.,* 13 B. T. A. 988, we have decided the question of

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amortization of bond discount adversely to him. In accordance with that decision we hold that petitioners here are entitled to the deductions claimed on account of bond discount.

The other question under these issues has been decided against the petitioners' claims in the *Chicago, Rock Island & Pacific* case, *supra*, at pages 1034, 1035, and in *Kansas City Southern Railway Co.*, 22 B. T. A. 949, 966. We have carefully considered petitioners' arguments against the propriety of the decisions cited, but we are not convinced that they are wrong and so we adhere to them in the present proceedings and hold that petitioners are not entitled to the deductions claimed on account of commissions.

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Motion for Review of Report by Full Board.

(Filed Oct. 24, 1932.)

UNITED STATES BOARD OF TAX APPEALS,

UNION PACIFIC RAILROAD COMPANY, OREGON SHORT LINE RAILROAD COMPANY, THE ST. JOSEPH AND GRAND ISLAND RAILWAY COMPANY, SAN FRANCISCO AND PORTLAND STEAMSHIP COMPANY, by Oregon-Washington Railroad & Navigation Company, successor, YAKIMA VALLEY TRANSPORTATION COMPANY, THE UNION PACIFIC COAL COMPANY, WASHINGTON UNION COAL COMPANY, OREGON AND WASHINGTON RAILROAD COMPANY, THE RATTLESNAKE CREEK WATER COMPANY, UNION PACIFIC WATER COMPANY, UNION PACIFIC EQUIPMENT ASSOCIATION, GREEN RIVER WATER WORKS COMPANY, PORTLAND TERMINAL INVESTMENT COMPANY, Petitioners, vs. COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket Nos. 35,639, to 35,649, 35,684, 35,685.

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OREGON-WASHINGTON RAILROAD & NAVIGATION COMPANY, as transferee of The San Francisco and Portland Steamship Company, Petitioner, vs. COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket No. 40,002.

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UNION PACIFIC RAILROAD COMPANY, LOS ANGELES & SALT LAKE RAILROAD COMPANY, DES CHUTES RAILROAD COMPANY, Petitioners, vs. COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket Nos. 40,060, to 40,062.

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Now come the petitioners, by their counsel of record, and move that, in accordance with Section 601 of the Revenue Act of 1928, the Chairman of the Board direct that the report of the Division, promulgated October 7, 1932, in the above proceedings, shall be reviewed by the full Board.

In support of this motion counsel state that two of the issues in said cause are of such importance that a review by the full Board is desirable. Issue L involves approximately $500,-

166 *Motion for Review of Report by Full Board.*

000.00 taxes and relates to a loss in 1921 through the exchange of certain bonds for bonds of the Los Angeles & Salt Lake Railroad Company pursuant to a contract with the late W. A. Clark. Issue P for 1920-1922 and issue H for 1923 involve the amortization of commissions on bonds issued prior to 1913, and the amount of taxes in dispute is approximately $6,000.00 for each of the years before the Board, but this issue is also in controversy between the parties
167 for later years, some of which are pending before the Board and others are now in audit. Counsel feel that the importance of these issues suggest a review of the report promulgated herein by the entire membership of the Board of Tax Appeals, and it is hoped that the Chairman will direct such review within thirty days from October 7th, as required by law.

October 24, 1932.

HENRY W. CLARK,
HARRY J. GERRITY,
Attorneys for Petitioner.

168 Denied.

Oct. 25, 1932.

(Signed) JOHN M. STERNHAGEN,
Acting Chairman,
U. S. Board of Tax Appeals.

169

Decision.

Docket Nos. 35639 and 40060.

Counsel for petitioners have filed a proposed recomputation in the above-entitled proceedings and counsel for respondent has noted thereon that the proposal is in accordance with the opinion of the Board heretofore promulgated. Wherefore, in accordance with the petitioners' proposal, it is

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ORDERED and DECIDED that in the case of the Union Pacific Railroad Company there is a deficiency for the year 1920 in the amount of $496,768.09 and that for the years 1921, 1922 and 1923 there are overpayments in the respective amounts of $93,630.42, $34,196.92 and $58,986.52, and it is

FURTHER ORDERED and DECIDED that there is no deficiency in income or profits taxes due from, or overpayments due to, the several other petitioners above named.

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Enter.

(Signed) C. R. ARUNDELL,
Member.

Entered Dec. 3, 1932.

(Seal of Board of
Tax Appeals)

172 **Petition for Review.**

(Filed Jan. 21, 1933.)

UNITED STATES BOARD OF TAX APPEALS,

Docket Nos. 35,639 and 40,060.

UNION PACIFIC RAILROAD COMPANY,
Petitioner,
against
173 COMMISSIONER OF INTERNAL REVENUE,
Respondent.

UNION PACIFIC RAILROAD COMPANY, petitioner, is aggrieved by a decision of the United States Board of Tax Appeals rendered on the 3rd day of December, 1932, in the cases of *Union Pacific Railroad Company,* Petitioner, v. *Commissioner of Internal Revenue,* Nos. 35,639 and 40,060 on the docket of the Board, determining that there
174 is a deficiency in petitioner's Federal income tax for the year 1920 in the amount of $496,768.09 and that for the years 1921, 1922 and 1923 there are overpayments in the respective amounts of $93,630.42, $34,196.92 and $58,986.52, and respectfully submits its petition for a review thereof by the Circuit Court of Appeals for the Second Circuit.

I.

VENUE

The petitioner's income tax return for each of the years aforesaid, being consolidated re-

turns for petitioner and its affiliated companies, was filed in the office of the United States Collector of Internal Revenue for the Second New York District located in the Second Judicial Circuit.

II.

NATURE OF THE CONTROVERSY

The controversy involves the determination of petitioner's liability for Federal income taxes for the calendar years 1920, 1921, 1922 and 1923. 176

Loss on Clark Trade—1921.

Petitioner appeals from the adverse decision of the Board on the issue designated as Issue L in its amended petition to the Board in Docket Number 35,639.

Pursuant to a contract dated April 27, 1921, between petitioner and one William A. Clark, petitioner delivered to said Clark and other persons certain bonds issued by Southern Pacific Railroad Company, Southern Pacific Company 177 and Oregon Washington Railroad & Navigation Company, respectively, to an aggregate amount exceeding $29,000,000, face value, and received in exchange therefor approximately the same amount, at face value, of bonds issued by Los Angeles & Salt Lake Railroad Company. Petitioner asserts that it incurred a loss of $5,243,312.99 upon said exchange of bonds, being the difference between the cost to petitioner of the bonds so delivered by it and the market value of the bonds so acquired in exchange, subject to a small adjustment made in cash, and that it is

178 *Petition for Review.*

entitled to the deduction of said loss in the computation of its income tax liability for the year 1921 under the provisions of the Revenue Act of 1921. The Board of Tax Appeals has held that the said exchange of bonds was one on which no loss is entitled to recognition.

Amortization of Bond Commissions—1920, 1921, 1922 and 1923.

179 Petitioner appeals from so much of the decision of the Board as is adverse to it on the issue designated as Issue P in its amended petition to the Board in Docket Number 35,639 and Issue H in its amended petition in Docket Number 40,060.

Prior to 1913 petitioner and one of its affiliated companies made certain issues of corporate bonds and sold the same at a discount and incurred in connection therewith certain bankers' and underwriters' commissions. Petitioner asserts that both the discount and the commissions

180 incurred as aforesaid may be amortized over the life of the said bonds and the annual amortization deducted in the computation of petitioner's income tax liability for each of the years 1920 to 1923, inclusive, under the Revenue Acts of 1918 and 1921. The Board of Tax Appeals has allowed the annual amortization of said discount but has held that said commissions may not be amortized. The annual amortization of said commissions amounts to $57,252.57.

ASSIGNMENT OF ERRORS

The Board of Tax Appeals erred in its decision aforesaid in the following respects:

Petition for Review. 181

Loss on Clark Trade—1921.

1. In refusing to allow as a deductible loss for the year 1921 the difference between the cost to the petitioner of the bonds of Southern Pacific Railroad Company, Southern Pacific Company and Oregon-Washington Railroad & Navigation Company delivered by petitioner and the market value of the bonds of the Los Angeles & Salt Lake Railroad Company received by petitioner in exchange for said first mentioned bonds, pursuant to the contract of April 27, 1921, between petitioner and William A. Clark, and, more particularly, the following rulings as the bases of such refusal: 182

(a) In holding that said exchange of bonds was within the purpose and intent of Section 202, paragraph (c)(1), of the Revenue Act of 1921, excluding from recognition gains or losses on certain exchanges of property.

(b) In holding that the bonds of the Los Angeles & Salt Lake Railroad Company received in the exchange aforesaid were acquired for investment within the meaning of said Section 202(c)(1). 183

(c) In finding contrary to the uncontradicted evidence that the bonds of the Oregon-Washington Railroad & Navigation Company delivered in the exchange aforesaid were held by petitioner for investment and refusing to find in accordance with the uncontradicted evidence that said bonds were

184 *Petition for Review.*

held primarily for sale, both within the intent of said Section 202(c)(1).

Amortization of Bond Commissions—1920, 1921, 1922, 1923.

2. In refusing to allow as a deduction from income in each of the years 1920, 1921, 1922 and 1923 the amount of $57,252.57 as annual amortization of commissions of bankers and underwriters incurred upon issues of bonds of the
185 petitioner and one of its affiliated companies made prior to 1913.

Dated, January 18, 1933.

HENRY W. CLARK,
120 Broadway,
New York, N. Y.

HARRY J. GERRITY,
Hill Building,
186 Washington, D. C.
Counsel for Petitioner.

State of New York, }
County of New York, } ss.:

HENRY W. CLARK, being duly sworn, deposes and says: That he is a Vice-President of Union Pacific Railroad Company, the petitioner named in the foregoing petition, and is duly authorized to verify said petition; that he has read said petition and is familiar with the statements contaned therein; and that the facts stated therein are true except as to those facts stated to be

upon information and belief and those facts he believes to be true.

HENRY W. CLARK.

Sworn to before me this
18th day of January, 1933.

JOHN M. LEE,
Notary Public.
New York County No. 62.
New York Reg. No. 4L235.
Cert. filed in Nassau County.
Com. expires Mar. 30, 1934. 188

(Seal)

Statement of Evidence.

UNITED STATES BOARD OF TAX APPEALS.

UNION PACIFIC RAILROAD COMPANY, 189 against COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket Nos. 35,639 and 40,060.

(Filed Jan. 31, 1933.)

The following is a statement of evidence submitted to the Board of Tax Appeals in the above entitled case, so far as is necessary to the assignment of errors as filed, reduced to narrative form:

190 *Statement of Evidence.*

TESTIMONY OF HENRY W. CLARK

HENRY W. CLARK, called as a witness on behalf of petitioner, testified as follows:

I was General Counsel of Union Pacific in 1921.

The contract dated April 27, 1921, shown me, between William A. Clark and Union Pacific Railroad Company is a duplicate original of the
191 contract which it purports to be. I am familiar with the signatures thereto of the Chairman and Secretary of Union Pacific Railroad Company and of Senator W. A. Clark. They were all affixed in my presence and duplicate originals of the contract were exchanged in my presence.

The contract was offered in evidence and received as *"Petitioner's Exhibit No. 5"*. A copy is attached to this statement of the evidence.

192 TESTIMONY OF ROBERT S. LOVETT

ROBERT S. LOVETT, called as a witness on behalf of petitioner, testified as follows:

On Direct Examination:

I am Chairman of the Board of Directors of the Union Pacific Railroad Company and its principal subsidiaries. I was throughout 1920 and 1921, and for some years prior thereto, Chairman of the Executive Committee of the Union Pacific Railroad Company and as such its Chief Executive Officer. I am familiar with

the contract between the Union Pacific Railroad Company and Senator Clark which has just been received in evidence as petitioner's Exhibit No. 5. I personally negotiated on the part of the Union Pacific Railroad Company the trade embodied in that contract. The negotiations were conducted principally with Senator Clark, but also with his brother J. Ross Clark, located at Los Angeles operating headquarters of the property involved, and with E. D. Kenna whose wife was partly interested with Senator Clark in the 194
ownership of the securities of the company. Mr. Kenna was one of the Board of Directors of the Los Angeles & Salt Lake Railroad Company, nominated by the Clark interests.

The recitals to this contract state that one-half of the stock of the Los Angeles & Salt Lake was owned by the Oregon Short Line and all but a few shares of the remaining half of Senator Clark. The third parties who held those few remaining shares were identified with Senator Clark. During this joint ownership of the Los Angeles & Salt Lake Railroad Company one- 195
half of the Directors were nominated by the Union Pacific and Short Line interests and the other half by Senator Clark's interests, and Senator Clark was President during the whole period until he disposed of his ownership. That was true from about 1904 and continued until after the signing of the contract which has been introduced in evidence. The Union Pacific was entirely satisfied with the joint management to which I have testified. I mean it was harmonious. Of course, it was not the same as the management under sole ownership by the Union Pacific would be. As to the advantages which I

considered would accrue to the Union Pacific as sole owner which it did not enjoy as a joint owner, I could not enumerate them all but one of the first considerations would be that, if the Union Pacific owned the property entirely, it would immediately include it in its general system and the jurisdiction of its operating officers and traffic officers would be extended over it.

The President of the Union Pacific who is located at Omaha had no control over the Salt
197 Lake road. The traffic department of the Union Pacific had no control except, of course, as to certain through traffic under an understanding it could get rates to meet competition, but it had no control over traffic wholly on the Salt Lake. Train schedules could not be made or changed on the Salt Lake road by the Union Pacific Line under joint control. All of that would be changed under sole ownership and those matters would be under the control of the operating department, operating matters, and the traffic arrangements would be under the
198 traffic department of the Union Pacific, and changes in schedules and otherwise could be made at their pleasure, subject, of course, to the law. But now with the joint control no changes could be made in any of those matters without consultation with the Clark interests and in view of the very fierce competition as to all through traffic, control by the Union Pacific and the power to bring immediate action we deemed very important. I thought I made it clear or indicated that the Union Pacific operating organization, that is our President and his staff that operate the Union Pacific System had no control itself over the operations of the Salt

Lake Railroad under joint management. Under sole control, of course, they would have complete control over the Salt Lake Line just as they would have over the Union Pacific's own lines. 199

Prior to 1921 the Union Pacific had no entrance into Southern California except through its relationship with the Salt Lake Railroad. I considered at that time, or before that time, that it was to the advantage of the Union Pacific to have its own entrance into Southern California. In view of the considerations I have named the Union Pacific management, prior to 1921, wanted sole ownership of the Salt Lake Railroad. 200

I first took up with Senator Clark or anyone representing him the question of buying his half of the stock in the Salt Lake Railroad some four or five years before making the contract of 1921. I approached Senator Clark on the question of buying his interest and he answered that he would not know what to do with the money if he sold it, and we had some discussion on that difficulty. I suggested that the Union Pacific ought to have it, that he was not in the railroad business. Without going into all of the arguments here I tried to convince him that he should sell to the Union Pacific and use his money in some other way and that sole control was necessary to making the road a success with competition we had and he finally, after a good deal of hesitation said: "Well, if you really feel that the Union Pacific ought to own it, that it should be a single line, I am willing to sell, or sell my stock at par but no less". I told him if that was really his feeling about it we would not discuss 201

202 *Statement of Evidence.*

it any further and we both should forget it and the subject was not mentioned again until along in 1921. That price was entirely beyond reason. At that time we discussed only the question of buying his half of the stock. There was no discussion of buying his bonds.

In the latter part of 1920 we had some further discussion of acquiring his interest. I can't give the exact date. That conversation was with E. D. Kenna who, as I say, was interested or
203 his wife was interested in the ownership of some of the securities, stock or bonds. I do not know what their exact relations were but he was one of the associates of Senator Clark, what we called Clark directors of the Salt Lake road. He wanted to sell, he thought that Senator Clark wanted to sell. The Senator was getting very old and he thought he should sell. We discussed the value, the price to be put on the stock, or the question involved two points, the bonds, the question of the bonds as well as the stock. I also had a discussion with J. Ross Clark who
204 was part owner of the so-called Clark interest. The Senator at that time was willing to keep the bonds if the Union Pacific would guarantee them. At first I was disposed to agree to that, but I did not give it really very much consideration. The negotiations at that time resulted in inability to get together on the price of the stock.

Negotiations were resumed early in 1921, first with J. Ross Clark who was second Vice President or one of the managers connected with the management of the operations in Los Angeles, and as I say he was part owner of the Clark interests; then with Mr. Kenna and finally with

Senator Clark when I got back to New York. In these final negotiations I insisted that we wanted the bonds as well as the stock and gave my reasons as to why that was so. The main consideration was to get all of this stock and thus secure the merging of control of the company, but these bonds were first lien on practically 1,000 miles of railroad. The Union Pacific owned $29,000,000 and the Clark interests owned $29,000,000 in equal amounts and I conceived the idea that there was a good bit of money invested in them and a great deal more would be required and we wanted the bonds in order to have all of them. We could cancel them if further financing was deemed necessary; we could cancel that mortgage and cancel the bonds on all of that merged property in the Union Pacific, and when further financing became necessary as it would probably in a few years we would issue a new mortgage. This mortgage was limited to a maximum issue of $70,000,000 which left a margin outside of those owned by Senator Clark and the Union Pacific of $10,000,000, which was too small for future development of the property and that we would cancel or in lieu of that we would put on a new mortgage for the Union Pacific System. Such new bonds, secured by mortgage covering the entire Union Pacific System as a lien inferior to the outstanding bonds of the Union Pacific Lines, but would be a first lien on about 1,000 miles constituting the road we are talking about, the Los Angeles & Salt Lake, and we were advised by our bankers that a first lien on that much railroad of the Union Pacific mortgage, a first lien feature would be most helpful in getting a good price for bonds. Among

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208 *Statement of Evidence.*

the other Union Pacific lines we had at that time no mileage available as first lien mileage for any new financing, that I recall. There may have been a little branch here and there, but I recall none.

I do not know that I can summarize my purpose in acquiring the Salt Lake bonds from Senator Clark other than to state it was to acquire ownership of every bond in connection with the acquisition of the mileage secured or
209 covered by the lien of the mortgage, to get in a position to cancel those bonds and make a new and larger mortgage whenever our requirements made it necessary that would be a first lien on this mileage aggregating about 1,000 miles. We never at any time intended and never since as officers of the company contemplated the sale of these bonds, but merely holding them until such time as we should find it advisable to finance by issuing such mortgage. We did not acquire those bonds for investment or for productive use or otherwise than in the manner in which I have
210 stated.

As to reason for issuing in 1914 the bonds of the Oregon-Washington Railroad & Navigation Company which were given in exchange in this Clark trade, something over $14,000,000, which the pleadings admit were acquired by the Union Pacific in 1914: There had been discussions and proposals for some years, I do not recall how long, of legislation looking to the regulation of the issuance of securities by the Interstate Commerce Commission, and my thought was that if the company issuing the bonds sold them, even though to the parent company, that it might leave us as free as we had

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been at that time in afterwards selling the bonds, and I, for that reason, instructed counsel to arrange with the various subsidiaries that we controlled, including the O-W. R. & N., and I think the Oregon Short Line, to secure from the trustee the certification of such bonds as we might be entitled to. I do not know whether these bonds were actually in the treasury at that time or not. We then took up with the Committee or Board the question of selling the bonds to the Union Pacific, and that, of course, was the

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proceeding, the idea being to anticipate legislation which might impose very great restrictions on the issuance of securities which in those States had been free heretofore, and, largely, I might say, almost exclusively that consideration entered into the purchase of the bonds. The Union Pacific expected to hold them and sometime in the future, perhaps, to guarantee them and sell them. In the meantime I would say that the Union Pacific did not hold them for investment or for any productive use, because we owned all of the stock.

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Although these bonds were acquired by the Union Pacific from its subsidiary in 1914 they were still on hand, unsold in 1921, available for this Clark trade. From the outbreak of the European War there was practically no market for four per cent. bonds, and we had no purpose in selling them. We had other resources, and, as I say, these bonds really were not saleable because they were four per cent. bonds, except at ruinous discount.

On Cross Examination:

Senator Clark did not, so far as I know, own stock in the Union Pacific Railroad at the time

the stock and bonds of the Los Angeles & Salt Lake Railroad Company were acquired.

These bonds of the Salt Lake company were not cancelled and retired. None of them have been cancelled and retired up to the present. The Union Pacific still owns all of them. The mortgage securing these bonds has not been released but is still in effect.

The Navigation Company bonds which were exchanged for the Salt Lake Company's bonds were acquired in 1914 by the Union Pacific. I
215 don't know whether the Navigation Company paid interest on those bonds during the period they were held by the Union Pacific or whether we cancelled the coupons. I couldn't tell you that, because we regarded it as amounting to the same thing.

All of the bonds of the Navigation Company acquired in 1914 were held by the Union Pacific up until the date they were exchanged for the Salt Lake Company's bonds. Of course, previous to that, it had acquired bonds from the Navigation Company which it sold long before that.
216 But it didn't sell any of the bonds acquired in 1914.

The stock of the Salt Lake Company acquired by the Union Pacific covered all of the outstanding stock, except what the Union Pacific, through the Oregon Short Line, already owned. The Oregon Short Line was a subsidiary of the Union Pacific. And the Navigation Company was also a subsidiary of the Union Pacific through the Oregon Short Line—the Union Pacific owned 100 per cent. of the Oregon Short Line stock, and the Oregon Short Line, as I recall, owned all the stock of the Navigation Com-

pany except qualifying shares for directors on which we had options. That condition existed all of the time from 1914 up through 1921.

I don't recall whether the Union Pacific ever disposed of any of the bonds that it had acquired in the Southern Pacific Company prior to 1921. I couldn't answer as to what we did, or may not have done with respect to the Southern Pacific bonds because the companies had been separated by the courts in 1913, and the Union Pacific no longer had any control over, or interest in, the Southern Pacific; and while it held some of the bonds that it had acquired before they were separated by the courts, I could not answer as to—. Those bonds which they held were bonds that were exchanged for the Salt Lake Company's bonds. The Union Pacific, from about 1901, I think, began to acquire stock of the Southern Pacific, and it acquired practically control—that is, 46 per cent. of the capital stock of the Southern Pacific, which it held until 1913 when the Government brought suit under the anti-trust laws claiming that the control of the Southern Pacific by the Union Pacific was in violation of the anti-trust law. The Supreme Court so held in a case decided in December, 1912, and ordered the Union Pacific to discontinue and cease that control, and dispose of its stock; and pursuant to the decree of the Supreme Court we disposed of all of that stock in 1913. We owned and still own some bonds of the Southern Pacific that we had acquired when we regarded it somewhat as a subsidiary; not complete control of it, but as I say, we only owned about 46 per cent. of the outstanding stock. But we held some of those bonds. Whether

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220 *Statement of Evidence.*

we had disposed of some of them before the date of the trade with Senator Clark or not I don't remember. I know that we had the amounts stated in the contract there, on hand and unpledged, at the time of the trade with Clark. Those were a part of the bonds which had been acquired prior to the date the Southern Pacific stock was disposed of.

On Re-direct Examination:

221 These Salt Lake bonds, acquired from the Senator in 1921 have not been cancelled up to date because we have had no need to issue, or if we had need to issue, we didn't have any opportunity to make a satisfactory issue of the extensive financing that I had in mind that, some time or other, the company might have to do. We have had other resources; and, therefore, we have left these bonds as they were; knowing that, at any time, owning all of them—there may be one or two outstanding yet—all of the stock
222 of the company, and all of the bonds, that at any time we wanted to do such financing we could proceed with it by simply cancelling the mortgage and providing for a new mortgage, and cancelling the bonds.

In the meantime there has been necessity for the Union Pacific to do some financing or refinancing. In 1927, for instance, there was a maturity of Union Pacific convertible bonds. As to how that maturity was financed I haven't got the dates fixed. There were two or three small, comparatively small issues, that matured. There was one in 1922. I can't answer from memory as to these dates very well. But I think,

as to one of those issues, we probably arranged for an extension of it for some years. There was another issue of Oregon Short Line—I think it was an issue of the Oregon Short Line's bonds—refunded with that issue. I haven't looked this up—it is some years ago—but my recollection is that we made one issue of bonds of the Oregon Short Line, about 26 millions, something like that I think, of mortgage bonds of the Oregon Short Line, guaranteed by the Union Pacific. Then there was an issue of 45 millions of the 224
Oregon Short Line bonds, guaranteed by the Union Pacific—Oregon Short Line collateral bonds that matured the 1st of December in 1929, that we paid off in cash, reducing the mortgage debt that much. Some of the small issues were paid off in cash. Until recent years we have had pretty large surplus earnings from the system as a whole, from investments and otherwise, and the small issues we could sometimes pay off, or we would have other assets that we could use. But we have issued no mortgage, except this Oregon Short Line mortgage in 1926, so far as 225
I recall, since this contract with Clark was made; and we certainly have issued no system mortgage, and no mortgage covering the Los Angeles & Salt Lake Railroad. I am not sure that we have made a Short Line mortgage, or a Short Line mortgage bond issue, since 1921.

If the Navigation Company had paid interest to the Union Pacific on those Navigation bonds held by the Union Pacific between 1914 and 1921, assuming that the interest was paid, the payment would have been effected and handled by cancelling the coupons and crediting the Navigation Company in an open account on the books

226 of both the Union Pacific and of the Navigation Company itself. It would have been simply an open-account transaction.

AMENDMENT OF PLEADING.

Mr. Clark: If your honor please, while we are at this point I think I will move to amend our pleadings upon this issue in a slight respect. Paragraph 78 alleges:

227 "Said Salt Lake bonds were not acquired by said Union Pacific Railroad Company as an investment, but as a means of acquiring a one-half interest in the Salt Lake railroad theretofore owned by said Clark, and so securing the operating control of the railroads of that company."

And the last sentence of the same paragraph alleges:

228 "Said Clark was not willing to dispose of his stock interest in said Salt Lake company, without disposing of his holdings of bonds of said company, and made it also a condition of said contract that the other holders of said bonds should have the privilege of disposing of their bonds upon the same terms."

In making those allegations in the petition, in the pleadings, I thought that I was stating the facts exactly, but Judge Lovett's recollection of the matter is more accurate than mine, and necessarily so, because he was the actual negotiator. So that there is a slight variance between the allegations which I have just read and the

testimony which we have given as to the purpose of our acquiring the Salt Lake bonds.

Therefore, I move to amend the pleadings in respect of paragraph 78 of the amended petition for 1920 to 1922 by striking out the first sentence of paragraph 78 and substituting the following language:

> "Said Salt Lake bonds were not acquired by the Union Pacific Railroad Company as an investment or for productive use, but as an incident to the acquisition 230 of the stock interest in the Salt Lake company theretofore held by said Clark, and for the purpose of canceling said bonds, discharging the mortgage securing the same and making the property of the Salt Lake company available as a first lien security for new financing, either of the Salt Lake company itself or of the Union Pacific System, whenever needed in the future."

And then strike out the last sentence of that 231 paragraph which seems to be entirely inaccurate.

Mr. Algire: I have no objection to the amendment, your honor.

The Member: It will be allowed.

Mr. Algire: I would like to have the record show that the respondent's answer to the paragraph, as amended, is the same as the answer to the amended petition.

Mr. Clark: In other words a complete denial?

Mr. Algire: A complete denial of the paragraph.

Mr. Clark: That is agreeable.

232 *Statement of Evidence.*

The Member: Very well.

Mr. Clark: I offer in evidence a certified copy of the action of the Union Pacific Railroad Company's executive committee on April 19, 1921, authorizing the Chairman to proceed with the Clark trade on the terms which were embodied in the contract of April 27, 1921. This is certified, Mr. Algire, by the secretary. I suppose you do not want any further proof of it. I can prove it.

233 Mr. Algire: No objection.

The Member: It will be received.

(Said document so offered and received in evidence was marked "Petitioner's Exhibit No. 6". A copy is attached to this statement of the evidence.)

TESTIMONY OF HENRY W. CLARK.

HENRY W. CLARK, recalled as a witness on behalf of petitioner, testified as follows:

234 *On Direct Examination:*

I am offering this testimony because Judge Lovett's memory wasn't entirely accurate about the subsequent financing. In 1922 some funds were required and although I am quite sure—I know—there was not any maturity to be refunded at that time, just needed for general funds, an issue was made and sold by Kuhn, Loeb & Company of some first lien and refunding bonds of the Union Pacific Railroad Company. Those were bonds under an existing mortgage that had been in the treasury for some time; and as the original issue was a 4 per cent.

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bond, and at that time 4 per cent. bonds weren't readily salable; so we modified the mortgage by a supplemental indenture permitting the issue of additional bonds at 5 per cent., and made this mortgage bond issue 5 per cent. under the existing mortgage, as I state.

The next financing by any of the Union Pacific companies occurred in 1927. In that year there matured about 26 millions of convertible bonds, which had been issued 20 years earlier by the Union Pacific Railroad Company, and it was found possible to refund that maturity by the issuing of some 4 per cent. debentures. That is not a mortgage bond, at all, just an unsecured promise to pay by the Union Pacific Railroad Company.

236

In the following year, 1928, we had another maturity, namely, of an issue of 20 millions of 6 per cent. collateral trust notes, that had been made by the Union Pacific Railroad Company in 1918, and we were able to refund that with an issue of debentures.

I think my former statement was wrong, that the debentures we issued in 1927 were 4½ and those issued in 1928 were 4 per cent.

237

Judge Lovett mentioned another large maturity of Oregon Short Line refunding bonds that was paid off in cash.

So that the three issues I have stated are the only securities issued, other than some equipment trust notes made by the Union Pacific, since 1921.

Mr. Clark: I am not sure, Mr. Algire, that it appears anywhere in our record that, prior to this Clark deal, the Oregon Short Line Railroad Company owned half of the capital stock of the

238 *Statement of Evidence.*

Los Angeles & Salt Lake Railroad Company. We allege that in paragraph 78, but it is covered by one of your denials; so I should like to have it appear of record. Will you admit that prior to 1921 the Oregon Short Line owned half of the capital stock of the Los Angeles & Salt Lake Railroad Company?

Mr. Algire: The respondent admits that, prior to the date on which the stock and bonds of the Salt Lake company were acquired by the Union
239 Pacific from Senator Clark, Oregon Short Line Railroad Company owned one-half of the outstanding capital stock of the Salt Lake company.

The Member: That was testified to by Judge Lovett, too.

Mr. Clark: I did not think we put that in.

Mr. Algire: I do not recall whether he testified as to the stock. He testified with respect to the bonds, but I am not sure about the stock; it may be that it is in the record.

Dated, January 25, 1933.

240 HENRY W. CLARK,
HARRY J. GERRITY,
Counsel for Petitioner.

January 30, 1933.

No objection to the foregoing Statement of Evidence.

C. M. CHAREST.

Approved and ordered filed this 31st day of January, 1933.

C. ROGERS ARUNDELL,
Member.

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Petitioner's Exhibit No. 5.

AGREEMENT made this 27th day of April, 1921, between WILLIAM A. CLARK, party of the first part, and UNION PACIFIC RAILROAD COMPANY, a corporation of the State of Utah (hereinafter called "Union Pacific") party of the second part.

WHEREAS: The Los Angeles & Salt Lake Railroad Company, a corporation of the State of Utah, (hereinafter called the "Salt Lake Company"), has outstanding $25,000,000, par value, 242
of capital stock consisting of 250,000 shares of the par value of $100 each. Certificates representing 243,866 shares of said capital stock are deposited with The Farmers' Loan and Trust Company under an agreement (hereinafter called the "Stock Trust Agreement") dated June 7, 1903, as extended and supplemented by agreement dated May 1, 1915, made by and between said Clark, Edward H. Harriman (Robert S. Lovett, successor) and The Farmers' Loan and Trust Company as Trustee. Certificates represented 5080 shares of the Salt Lake Company's 243
stock are owned by and in the possession of said Clark and said Clark expects to acquire the 1054 remaining shares now outstanding. Said Stock Trust Agreement may be terminated at any time by mutual agreement of the parties thereto. Said Lovett is a party to said Stock Trust Agreement in place of Edward H. Harriman, deceased, and representing the interest of the Oregon Short Line Railroad Company in the deposited stock. The Oregon Short Line Railroad Company is a subsidiary company of the Union Pacific, all of whose capital stock is owned by

244 *Petitioner's Exhibit No. 5.*

the Union Pacific. Subject to the said Stock Trust Agreement, said Oregon Short Line Railroad Company owns 125,000 shares of the capital stock of the Salt Lake Company deposited under said Agreement and said Clark owns the remaining 118,866 of said deposited shares. The Salt Lake Company has outstanding First Mortgage Gold Bonds due in 1961 to the amount of $59,-022,000, face value, bearing 4 per cent. interest payable on January 1 and July 1. One-half of
245 said bonds, to wit, $29,511,000, face value, are owned by said Oregon Short Line Railroad Company. The remainder of said bonds are owned by said Clark and members of his family and by parties for whom said Clark desires to secure equal advantages with himself in respect of said bonds. The Union Pacific is willing to acquire the 123,946 shares of the capital stock of the Salt Lake Company owned by said Clark and the additional 1054 shares which said Clark expects to acquire as aforesaid and as an additional consideration to acquire said bonds of the Salt Lake
246 Company in exchange for other bonds as hereinafter provided.

Now, Therefore, it is agreed as follows:

1. Said Clark hereby agrees to sell, assign and transfer to the Union Pacific 125,000 shares of the capital stock of the Salt Lake Company and the Union Pacific hereby agrees to purchase said shares, at $20 per share being the total sum of $2,500,000, and upon the further consideration of the acquisition by the Union Pacific of the bonds of the Salt Lake Company, as hereinafter provided.

Petitioner's Exhibit No. 5. 247

2. To the end that the foregoing agreement may be performed the Stock Trust Agreement shall be cancelled and the shares of capital stock of the Salt Lake Company deposited thereunder released and transferred on the books of the Salt Lake Company to the beneficial owners thereof or their assignees and nominees as their several interests in said shares shall appear.

3. The performance of the foregoing agreement of sale and purchase of the shares of the capital stock of the Salt Lake Company and of 248
the agreement hereinafter contained in respect of the acquisition by the Union Pacific of the bonds of the Salt Lake Company requires the authorization by the Interstate Commerce Commission of the guaranty by the Union Pacific of Oregon-Washington Railroad & Navigation Company First & Refunding Mortgage 4 Per cent. Bonds now in its treasury and their use in accordance with the provisions of this agreement in payment or exchange for the bonds of the Salt Lake Company and the 125,000 shares of the capital stock of said Company. Immed- 249
iately upon the execution of this agreement the Union Pacific will make application to the Interstate Commerce Commission for such authority and will prosecute such application diligently. Unless such authorization shall be granted by the Commission as will in the judgment of the Union Pacific expressed through its Board of Directors, Executive Committee or Chairman, sanction the performance of this agreement in all its terms, this agreement may be terminated by the Union Pacific by written notice to said Clark of its failure to secure such authorization. Unless such authorization shall be secured within

250 *Petitioner's Exhibit No. 5.*

six months from the execution of this agreement, or such extended period as shall have been mutually agreed upon, this agreement may be terminated by either party by written notice of such termination to the other.

4. Within thirty days after the authorization by the Interstate Commerce Commission, hereinbefore mentioned, shall have been granted, said Clark will deliver to the Union Pacific at its office in New York City the certificates repre-
251 senting the aforesaid 125,000 shares of the capital stock of the Salt Lake Company, duly assigned for transfer, and at least $25,000,000, face value, of the bonds of the Salt Lake Company having attached all unmatured interest coupons appertaining thereto and, if registered, accompanied by instruments of assignment and transfer duly executed.

5. The Union Pacific will upon the delivery of stock certificates aforesaid pay to said Clark in cash the sum of $20 for each said share being
252 a total sum of $2,500,000.

6. The Union Pacific will accept all said bonds of the Salt Lake Company delivered to it by said Clark as aforesaid, whether or not in excess of the amount of $25,000,000, face value, hereinbefore agreed to be delivered by said Clark, and will deliver to said Clark in exchange therefor the following: (1) Southern Pacific Railroad Company First Refunding Mortgage 4 Per cent. Bonds to an amount at face value equal to 30 per cent. of the face value of the bonds of the Salt Lake Company so delivered; (2) Southern Pacific Company San Francisco Terminal First Mortgage 4 Per cent. Bonds to an amount at

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face value equal to 20 per cent. of the face value of the bonds of the Salt Lake Company so delivered; and (3) Oregon-Washington Railroad & Navigation Company First & Refunding Mortgage 4 Per cent. Bonds guaranteed as to principal and interest by the Union Pacific, to an amount at face value equal to 50 per cent. of the face value of the bonds of the Salt Lake Company so delivered. All bonds so delivered in exchange by the Union Pacific shall be bonds payable to bearer (or registered as to principal 254
in such names as said Clark shall request) having attached all unmatured interest coupons appertaining thereto. The interest upon the Southern Pacific Railroad Company First Refunding Mortgage 4 Per cent. Bonds and upon the Oregon-Washington Railroad & Navigation Company First & Refunding Mortgage 4 Per cent. Bonds being payable on the same dates as the interest appertaining to the bonds of the Salt Lake Company, there will be no adjustment of interest in respect of said bonds upon such exchange. The interest appertaining to the 255
Southern Pacific Company San Francisco Terminal First Mortgage 4 Per cent. Bonds is payable April 1 and October 1 of each year and in respect of the exchange of said bonds there shall be an adjustment and settlement in cash of the difference between the interest accrued in respect of said bonds and the interest accrued in respect of 20 per cent. of the face value of the bonds of the Salt Lake Company received therefor.

7. The Union Pacific agrees that, upon tender to it by said Clark, or by any other holders,

256 *Petitioner's Exhibit No. 5.*

of additional amounts of said bonds of the Salt Lake Company for exchange upon the same basis and terms provided in the foregoing paragraph 6, the Union Pacific will make such exchange upon said basis and terms; provided that said additional bonds be so tendered within three months after the date of the original delivery of stock certificates and bonds provided for in the foregoing paragraph 4 or within a further period of three months if such extension shall in any
257 case be requested by said Clark.

8. The provisions as to exchange of bonds in the foregoing paragraphs 6 and 7 are subject to the following qualifications: The Southern Pacific Railroad Company First Refunding Mortgage 4 Per cent. Bonds are not issued in denominations of less than $500, face value. It is understood that the present holdings of bonds of the Salt Lake Company are such that, if all holders presented their entire holdings of said bonds for exchange on the basis provided in the foregoing paragraph numbered 6, said exchange
258 would involve 64 fractional amounts less than $500 of said Southern Pacific Railroad Company First Refunding Mortgage 4 Per cent. Bonds. Therefore the Union Pacific will settle for all fractions less than $500 in amount, face value, of said Southern Pacific Railroad Company First Refunding Mortgage 4 Per cent. Bonds, deliverable on the basis of exchange hereinbefore provided, in cash for the face value of said fractions and the accrued interest thereon; but no settlement for such fractions will be made except with those who are holders of said bonds of the Salt Lake Company on the date of this agreement or except for such fractions

as would result from the exchange of the entire number of such bonds held by them respectively on the date of this agreement.

9. Said Clark agrees that the Demand Notes of the Salt Lake Company held by himself and members of his family, now amounting to $1,548,930, face value, will not be presented for payment unless so requested by the Union Pacific prior to March 1st, 1922, and that any additional notes of said Salt Lake Company issued pending the performance of this agreement and held by 260
said Clark or members of his family and payable by their terms prior to the date aforesaid will not be presented for payment prior to said date unless so requested by the Union Pacific; provided in both cases that the interest currently maturing upon all such notes shall be duly paid.

10. The foregoing agreement of sale and purchase in respect of said 125,000 shares of stock and $25,000,000 face value, of said bonds of the Salt Lake Company is indivisible. The Union Pacific assumes no obligation to acquire said 261
stock without said bonds or to acquire less than the above stated amounts of either said stock or said bonds. Said Clark assumes no obligation to perform the foregoing agreement in part only, but is obligated to deliver said stock or said bonds only upon the performance by the Union Pacific of its foregoing agreement to acquire both said stock and said bonds.

11. All rights and obligations under this agreement shall inure to and be binding upon the executors or administrators of said Clark and the successors of said Union Pacific.

262 *Petitioner's Exhibit No. 6.*

IN WITNESS WHEREOF the above-named parties have executed this agreement the day and year above stated.

W. A. CLARK.

UNION PACIFIC RAILROAD COMPANY,

(Seal) By ROBERT S. LOVETT,

Attest: Chairman.

THOMAS PRICE,
Secretary.

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Petitioner's Exhibit No. 6.

Extract from Minutes of Regular Meeting of Executive Committee Union Pacific Railroad Company, April 19, 1921.

PURCHASE OF STOCK OF LOS ANGELES & SALT LAKE RAILROAD COMPANY.

The Chairman reported that negotiations for the acquisition of the stock of the Los Angeles & Salt Lake Railroad Company owned by W. A. Clark and his associates had so far progressed
264 that it was apparent that all said stock, with the possible exception of 1055 shares, could be acquired upon the terms hereinafter stated. Thereupon, it was unanimously

RESOLVED that the Chairman is directed to continue his negotiations and is authorized to acquire the 125,000 shares of the capital stock of the Los Angeles & Salt Lake Railroad Company, constituting all of the said capital stock other than that of which the Oregon Short Line Railroad Company is the beneficial owner, at the price of $20 per share, and upon the further consideration of the acquisition by this Company of any or all of the outstanding bonds of the

Petitioner's Exhibit No. 6. 265

Los Angeles & Salt Lake Railroad Company other than such bonds owned by the Oregon Short Line Railroad Company in exchange, dollar for dollar, for the following bonds now in the treasury of this Company, viz: (1) Southern Pacific Railway Company First Refunding Mortgage 4 Per cent. Bonds, (2) Southern Pacific Company San Francisco Terminal First Mortgage 4 Per cent. Bonds and (3) Oregon-Washington Railroad & Navigation Company First & Refunding Mortgage 4 Per cent. Bonds, guaranteed as to principal and interest by this 266
Company, in the proportion of 30, 20 and 50 per cent. of said several issues, respectively, and upon such terms in other respects as the Chairman shall in his discretion approve; and the Chairman is further authorized, in his judgment, in case of delay in securing the 1055 shares not now controlled by said W. A. Clark to consummate said transaction on the basis of 123,945 shares upon the same terms aforesaid.

I, Thomas Price, Secretary of Union Pacific Railroad Company, do hereby certify that the 267
above and foregoing is a true copy of an extract from the minutes of a regular meeting of the Executive Committee of the Union Pacific Railroad Company duly held at the principal office of the company in the City and State of New York on the 19th day of April, 1921, at which a quorum was present.

In Witness Whereof, I have hereunto subscribed my name and affixed the seal of said Company this 27th day of November, 1931.

Thomas Price,
Secretary.

(Seal)

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Praecipe.

UNITED STATES BOARD OF TAX APPEALS.

(Filed January 2, 1933.)

Docket Nos. 35,639 and 40,060.

UNION PACIFIC RAILROAD COMPANY, Petitioner,	
against	
COMMISSIONER OF INTERNAL REVENUE, Respondent.	

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TO THE CLERK OF THE UNITED STATES BOARD OF TAX APPEALS:

You are hereby requested to prepare and certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Second Circuit as the record on petition for review heretofore filed by the petitioner in the above entitled cases the following:

270

1. The docket entries of all proceedings before the Board of Tax Appeals in the above entitled cases.

2. The Amended petition in Nos. 35,639 *et seq.*, covering the years 1920 to 1922.

3. The amended petition in Nos. 40,060 *et seq.*, covering the year 1923.

4. Respondent's answer to the amended petition in Nos. 35,639 *et seq.*

Praecipe.

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5. Respondent's answer to the amended petition in Nos. 40,060 *et seq.*

6. Order consolidating said cases for hearing.

7. Opinion of the Board of Tax Appeals.

8. The petitioner's motion for a review of the decision by the full Board and the denial thereof.

9. The order of redetermination of the Board of Tax Appeals entered December 3, 1932.

10. Petition for review of the Board of Tax Appeals decision by the United States Circuit Court of Appeals.

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11. The statement of evidence with petitioner's Exhibits 5 and 6 attached thereto, when the same shall have been settled by the Board.

12. This Praecipe.

Dated January 27, 1933.

HENRY W. CLARK,
HARRY J. GERRITY,
Counsel for Petitioner.

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Clerk's Certificate.

UNITED STATES BOARD OF TAX APPEALS,

WASHINGTON.

UNION PACIFIC RAILROAD COMPANY, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.	Docket Nos. 35639 and 40060.

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I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 270, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of records in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

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In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 10th day of March, 1933.

B. D. GAMBLE,
Clerk,
United States Board of Tax Appeals.

(Seal)

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Stipulation and Order Omitting Certain Matter from Record.

UNITED STATES CIRCUIT COURT OF APPEALS,

FOR THE SECOND CIRCUIT.

UNION PACIFIC RAILROAD COMPANY,
Petitioner,
against
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

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IT IS HEREBY STIPULATED AND AGREED by and between the parties hereto that of the documents referred to below, copies of which are contained in the record filed herein, only the parts indicated below shall be printed.

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Amended Petition in Docket No. 35,639 of the Board of Tax Appeals, Income Taxes for 1920, 1921, 1922: The caption, excluding all docket numbers except 35,639, and the succeeding matter to the end of Part III. Of Part IV, the heading "IV". Assignment of Errors", the paragraph immediately following said heading, and the paragraphs designated by the letters L and P respectively. Of Part V, the heading "V. Facts" and the succeeding matter to but not including the caption "A—Apportionment of Consolidated Tax"; the caption "L—Loss on Clark Trade—1921" and the succeeding matter to and

280 *Stipulation and Order Omitting Certain Matter from Record.*

including paragraph numbered 82; the caption "P—Prior-to-1913 Bond Discount—1920, 1921, 1922" and the succeeding matter to and including paragraph numbered 121. Of Part VI, only its caption and introductory paragraph. The final paragraph of said Amended Petition, the date and signatures. Neither the verification nor the exhibits shall be printed.

281 *Answer to Amended Petition in said Docket No. 35,639*: The above docket number. The matter following the caption (which, except said docket number, is not to be printed) to the end of Part III. Of Part IV, the number "IV" and the paragraph designated by the letters K to P. Of Part V, the number "V", the heading *"General Allegation"*, the paragraph numbered 1, 2, 3 and 4, the caption "L—Loss on Clark Trade—1921", paragraphs numbered 71 to 82 inclusive, the caption "P—Prior to 1913 Bond Discount—1920, 1921, 1922", and the paragraph numbered
282 99 to 121. The final paragraph of said Answer, and the signature.

Amendment to Answer to Amended Petition in said Docket No. 35,639 is not to be printed.

Reply in said Docket No. 35,639 is not to be printed.

Amended Petition in Docket No. 40,060 of the Board of Tax Appeals, 1923 Income Taxes: The caption, excluding all docket numbers except 40,060, and the succeeding matter to the end of Part III. Of Part IV, the heading "IV. Assignment of Errors", the paragraph immediately following said heading and the paragraph desig-

Stipulation and Order Omitting Certain Matter from Record. 283

nated by the letter H. Of Part V, the heading "V. Facts" and the succeeding matter to but not including the caption "A—Apportionment of Consolidated Tax"; the caption "H—Prior-to-1913 Bond Discount" and the succeeding matter to and including paragraph numbered 63. Of Part VI only the caption and introductory paragraph. The final paragraph of said Amended Petition, the date and signature. Neither the verification nor the exhibits shall be printed. 284

Answer to Amended Petition in said Docket No. 40,060: The above docket number. The matter following the caption (which, except said docket number, is not to be printed) to the end of Part III Of Part IV, the number "IV" and the paragraph designated by the letters E to H. Of Part V, the number "V", the paragraph numbered 1, 2, 3 and 4, the caption "H—Prior-to-1913 Bond Discount" and the paragraph numbered 43 to 63. The final paragraph of said Answer, and the signature. 285

Amendment to Answer to Amended Petition in said Docket No. 40,060 is not to be printed.

Opinion of the Board of Tax Appeals in said Dockets Nos. 35,639 and 40,060. The above docket numbers. (The caption, except said docket numbers, is not to be printed.) The two paragraphs of the head notes entitled respectively "*Loss: Exchange of bonds for bonds*" and "*Amortization of discount and commissions on bonds issued prior to 1913.*" The heading "OPINION". The word and punctuation "ARUNDELL": and the

286 *Stipulation and Order Omitting Certain Matter from Record.*

three succeeding paragraphs. The heading beginning "Issue L" and all succeeding matter to but not including the heading beginning "Issue M for 1921 and 1922". The heading beginning "Issue P for 1920, 1921 and 1922" and all succeeding matter to but not including the heading beginning "Issue S".

Dated, April 5, 1933.

287 HENRY W. CLARK,
Attorney for Petitioner.

C. M. CHAREST,
Attorney for Respondent.

So ordered:

MANTON,
C. J.

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UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

UNION PACIFIC RAILROAD COMPANY

v.

COMMISSIONER OF INTERNAL REVENUE

Order of substitution

Upon motion of Guy T. Helvering, Commissioner of Internal Revenue, expressly consented to by the respondent, it is hereby ordered that said Guy T. Helvering, as such officer, be and he hereby is substituted for David Burnet, former Commissioner of Internal Revenue, and that this proceeding be so continued and maintained.

WM. PARKIN, *Clerk.*

Dated July 15, 1933.

United States Circuit Court of Appeals for the Second Circuit

No. 7—October term, 1933

UNION PACIFIC RAILROAD COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Argued December 18, 1933. Decided February 13, 1934

Appeal from the United States Board of Tax Appeals

Before L. Hand, Swan, and Augustus N. Hand, circuit Judges.

Union Pacific Railroad Company petitions for review of an order of the Board of Tax Appeals determining income tax liabilities for the years 1920 to 1923, inclusive. Reversed in part and remanded.

For opinion below, see 26 B.T.A. 1126.

Henry W. Clark, of New York City, for petitioner.

Sewall Key and Morton K. Rothschild, Sp. Assts. to Atty. Gen., for respondent.

SWAN, *Circuit Judge.*

The proceedings before the Board involved numerous controverted issues, of which only two have survived for review by this court. These two issues are entirely distinct. The one first to be considered relates to the taxpayer's claimed deduction of a loss incurred upon an exchange of bonds in the year 1921. The deduction was disallowed by the Commissioner and by the Board. The amount of the tax involved is more than five hundred thousand dollars.

Prior to the exchange of bonds hereafter to be described, the petitioner (for convenience referred to as Union Pacific) owned all the capital stock of Oregon Short Line Railroad Company, which in turn owned (1) all the capital stock of Oregon-Washington Railroad & Navigation Company (referred to as Navigation), and (2) one half the capital stock and one half the outstanding bonds of Los Angeles & Salt Lake Railroad Company (referred to as Salt Lake). The other half of Salt Lake stock and bonds was owned by Senator William A. Clark and members of his family. Under date of April 27, 1921, Union Pacific contracted with Senator Clark to buy at $20 per share the Salt Lake stock owned by him and his family and to exchange for Salt Lake bonds certain bonds owned by Union Pacific namely, Navigation bonds, Southern Pacific Railroad bonds, and San Francisco Terminal bonds. The cost to Union Pacific of the bonds it gave was $26,000,000, in round figures, and the market value of the Salt Lake bonds received in exchange was about $21,000,000. The difference, namely, $5,243,312.99, the petitioner claims as a loss deductible from gross income for 1921; while the Commissioner contends that the Board held, that no loss can be recognized because of section 202 (c) (1) of the Revenue Act of 1921 (42 Stat. 229, 230). This section reads as follows:

" (c) For the purposes of this title, on an exchange of property, real, personal, or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value; but even if the property received in exchange has a readily realizable market value, no gain or loss shall be recognized—

" (1) When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale), is exchanged for property of a like kind or use."

The dispute is whether, within the meaning of this statute, the bonds which Union Pacific disposed of were " property held for investment " and whether the Salt Lake bonds received in exchange were " property of a like kind or use." The Board found that the bonds given were held for investment and the bonds received were acquired for investment. These findings, the petitioner urges, are wholly without support in the evidence.

It is admitted that the Southern Pacific bonds and the Terminal bonds were held for investment, but it is contended that the Navigation bonds were " held primarily for sale." They were acquired by Union Pacific in 1914 from its wholly owned subsidiary, Oregon Short Line, having been issued in that year to anticipate possible State legislation which might impose burdensome restrictions on the issuance of securities. Union Pacific contemplated selling them at some future time, perhaps adding its own guaranty. From the time of their acquisition there was no satisfactory market for 4 per cent bonds, and, as Union Pacific had other resources, it continued to hold them until the time of the exchange in 1921. The Board held

that the petitioner had the burden of proving that the Navigation bonds were not held by it for investment, and that the foregoing facts were insufficient to so prove.

In making its contract with Senator Clark, Union Pacific had two objects in view. It desired to obtain exclusive operation control of the Salt Lake Railroad, and it desired to better its position for future financing when needed. By acquiring one half of the outstanding Salt Lake bonds, the remaining bonds being owned by Oregon Short Line, its subsidiary, it would be able at any time in the future when new financing was desirable to cancel the entire Salt Lake bond issue and thus have 1,000 miles of railroad available for a new first lien mortgage. It was never contemplated that the Salt Lake bonds would be sold, and they were still on hand at the time of the hearing before the Board in December 1931.

We think the Board was clearly correct in holding that the Salt Lake bonds were acquired for investment. Although one object in getting them was to be able to float a larger first mortgage should occasion arise, there was no refinancing plan on foot, and no one could foretell when the time would arrive. For ten years at least it did not. Meanwhile, the bonds were producing income, and the fact that they would produce income while held could not have been utterly ignored in acquiring them; the possible prospective purpose does not cancel the immediate and actual one. Property had been exchanged for income-producing bonds which were to be held for an indefinite period. This was an investment in the ordinary sense. It involved "a conversion of wealth from one form into another suitable for employment in the making of the hoped-for gains." *La Belle Iron Works* v. *United States*, 256 U.S. 377, 388, 41 S.Ct. 528, 530, 65 L.Ed. 998. Moreover, the acquisition of the bonds was inextricably tied to the acquistion of the Salt Lake stock under the April contract. That such purchase of stock was an investment could scarcely be questioned; and it would be difficult to ascribe a different character to purchase of the bonds under the same contract. If one bought income-producing improved real estate, it would hardly be argued that he made an investment in the land but not in the improvements, because he intended at some unknown future date to tear them down.

Since the Salt Lake bonds were acquired for investment, no loss can be "recognized" as resulting from the transaction insofar as they were exchanged for Southern Pacific and Terminal bonds, admittedly held for investment. Insofar as they were exchanged for Navigation bonds, the question is whether the latter were held for investment.

They were issued against the chance that legislation would impede issuing them later; Union Pacific wanted them ready to sell. But they had been held for 7 years without sale, and no one knows how long they might have been held had not the opportunity arisen to make this exchange. If one not a dealer in securities buys income-producing bonds for the purpose of sale at some unknown future time

when a favorable price can be realized or the owner's need for cash may require, it seems to us that in the common acceptation of the word he makes an "investment", and the bonds are "property held for investment" within the meaning of the statute. The parenthetical clause of the section under consideration, which contains the phrase "property held primarily for sale", refers, in our opinion, only to the words immediately preceding the parenthesis, that is, property held "for productive use in trade or business." This construction is not only more consistent with the punctuation of the paragraph, there being a comma after the word "investment" and at the end of the parenthesis, but it also finds corroboration in the form of the 1923 amendment of section 202 (c) (1), 42 Stat. 1560, which expands the parenthesis as shown below:

"(1) When any such property held for investment, or for productive use in trade or business (not including stock-in-trade or other property held primarily for sale, and in the case of property held for investment not including stock, bonds * * * or evidences of indebtedness or interest), is exchanged for property of a like kind or use."

The modification of this phraseology in the Revenue Act 1924, § 203 (b) (1), 43 Stat. 256, 26 U.S.C.A., § 934 (b) (1), does not we think, materially weaken the argument for this construction.

It is urged that the bonds of a wholly owned subsidiary are never held by the parent company for investment; that the holding of such bonds gives the parent company no investment which it would not otherwise have because the stock ownership of the subsidiary assures the parent realization of any net income of the subsidiary, and it is immaterial whether such income is realized by way of dividends or of interest on the bonds. The testimony was that, if interest was paid on the Navigation bonds, the payment would be evidenced simply by an entry in the open account between the companies. We cannot accede to this argument. When money of the parent corporation is loaned to the subsidiary in return for its obligation evidenced by bonds, the corporations are intended to be treated as distinct legal entities; the stock ownership of the subsidiary is immaterial. Within the meaning of the section under consideration, the purchase of bonds or stock of a subsidiary is an "investment" as much as would be a similar purchase of bonds or stock of any unrelated corporation. We conclude, therefore, that the Navigation bonds were held by Union Pacific for investment; hence no loss can be "recognized" on the exchange.

The foregoing conclusions make it unnecessary to consider the petitioner's argument that the phrase "like kind or use" is to be read conjunctively as "like kind and use."

In approving the decision of the Board as to the first issue raised by this appeal we are not unmindful of the unfortunate situation in which the petitioner was placed by virtue of the retroactive feature of the Revenue Act of 1921. Had the transaction occurred earlier than 1921, there is no doubt that the petitioner would have sus-

tained a deductible loss, for the prior taxing acts contained no provision corresponding to the above-quoted section 202 (c) (1). Had the exchange been made subsequent to 1922, the loss would likewise have been deductible, for by the amendment already referred to the section was soon made inapplicable to an exchange of bonds. It is only because the Revenue Act of 1921, approved in November of that year, was made retroactive to January 1st, that the present dispute exists. Had the statute been enacted before the contract of April 27th was made, the transaction could easily have been so arranged that no question as to deducting the loss would have arisen. These considerations may elicit sympathy for the taxpayer, but they cannot be treated as relevant to a construction of the statutory language upon which decision of the controversy must hinge.

The second issue relates to the deduction in each of the taxable years under review of amortization of commissions on sales of bonds prior to 1913. Before 1909 Union Pacific and its subsidiary Oregon Short Line sold several issues of bonds at a discount and paid commissions to bankers for making or underwriting the sales. In the taxable years under review deductions were claimed for these discounts and commissions amortized over the life of the bonds. The Board of Tax Appeals allowed the deductions claimed on account of bond discount, but disallowed the deductions claimed on account of commissions. The latter amount to approximately $57,000 in each of the four years in question.

The petitioner argues with persuasive force that commissions should be dealt with on the same basis as discount; that it is immaterial whether corporate bonds are sold at a 4-percent discount, with a 2-percent commission paid to the bankers for selling or underwriting services, or are marketed at a 6-percent discount, with no payment of commission. In either case the corporation receives but $94 for each $100 which it promises to repay at maturity of the bond, and, when payment is made, a loss of $6 will be sustained; or, if incurring the obligation is considered as a realization of the loss, it will be sustained when the bond is issued. But to charge the whole loss to the business of the single year, either of issue or of payment, is contrary to recognized accounting practice and unfairly distorts the income for that year. Hence the accepted practice is to amortize it over the life of the bond.

The taxing authorities recognized this practice at an early date. In regulations 33 (revised), article 150 provided as follows:

"Art. 150: In cases wherein a corporation sells its bonds at a discount plus a commission for selling, the amount of such discount and commission, together with other expenses incidental to issuing the bonds, constitute a loss, the aggregate amount of which loss will for the purpose of an income tax return, be prorated over the life of the bonds sold, and the amount thus apportioned to each year will be deductible from the gross income of each year until the bonds shall have been redeemed."

Regulations 45, art. 544, and regulations 62, art. 545, relating respectively to the 1918 act and the 1921 act, contain a similar provision as to amortizing bond discount but omit any express reference to amortizing commissions or other expenses incidental to issuing the bonds. The practice of the Bureau, however, does not distinguish between discount and commissions and expenses with respect to bonds issued subsequent to 1913. 4 C.B. 276; 4 C.B. 129; I–2 C.B. 91; IV–1 C.B. 145; III–2 C.B. 245. In *Western Maryland Ry. Co.* v. *Commissioner of Internal Revenue*, 33 F. (2d) 695 (C.C.A. 4), it was held that the deduction in current tax years of amortization of bond discount must be recognized as well when the bonds were sold before the enactment of the income tax laws as when sold after. The Board had held the same in the *Chicago, Rock Island & Pac. R.R. Co.* v. *Commissioner of Internal Revenue*, 13 B.T.A. 988, 1027. There it was also held that expenses incurred in issuing bonds subsequent to 1913 should be amortized and deducted (page 1035), but that no such deductions could be allowed for incidental expenses with respect to bonds issued prior to 1913 (page 1034). This was affirmed in *Chicago R. I. & P. Ry. Co.* v. *Com'r*, 47 F. (2d) 990, 991 (C.C.A. 7). The precise nature of the expenses and whether they included commissions does not appear. The reason given by the Board for this distinction is stated at page 1035 of 13 B.T.A.:

"* * * We are of opinion that since the Circuit Court of Appeals [26 F. (2d) 408] has held in the *Old Colony Railroad Co. Case* [6 B.T.A. 1025], *supra*, that premiums actually received prior to March 1, 1913, are not taxable income, by the same token, expenses actually paid prior to said date are not deductible from gross income of taxable years."

It is not easy to select the precise provision of the statute which authorizes amortization and deduction either of bond discount or bond commissions. The petitioner has not attempted to pin its flag to a single specific phrase. Section 234 is the relevant section in both the Revenue Act of 1918 (40 Stat. 1077) and the Revenue Act of 1921 (42 Stat. 254). Separate paragraphs authorize the deduction from gross income of "ordinary and necessary expenses paid or incurred during the taxable year", of "interest paid or accrued", of "losses sustained" and of depreciation and exhaustion. Bond discount and commissions scarcely fall within the first category; they represent the cost of acquiring new capital, rather than an ordinary and necessary expense in carying on business during the year. Discount is often referred to as deferred interest, and deduction of amortized discount has been allowed under the "interest" paragraph. See *Western Maryland case*, *supra*. To us the "loss sustained" paragraph seems the more appropriate. Viewing discount and commissions as the cost of acquiring new capital, the loss is actually sustained when the bonds are paid or redeemed; but, since the use of the capital is extended over the life of the bonds, the income for any current year will be more fairly reflected by

prorating the loss over the period of such use. So the regulations provide, and, since the loss is really suffered when the bond is paid, that is, at a time when an income-tax law is in effect and hence at a time when the taxing officials may require the loss to be spread so as truly to reflect annual income, it is immaterial that the bonds were issued before the income-tax amendment. The analogies of depreciation deductions are persuasive. Rent or insurance paid in advance prior to 1913, or the purchase price of a wasting capital asset, such as a patent, would certainly be prorated over the years affected. See O.D. 720; 3 C.B. 145; T.D. 3414; reg. 45, arts. 163, 165, 168. A broker's commission for finding a tenant is required to be spread over the life of the lease on the theory that it is a cost of acquiring a wasting asset. See *Bonwit Teller & Co.* v. *Com'r*, 53 F (2d) 381, 384, 82 A.L.R. 325 (C.C.A. 2). The commission there involved was paid after the income-tax laws were effective, but the theory would be equally applicable had it been paid prior to 1913. It is true that in these analogous cases, the payment has resulted in acquiring an asset which year by year is exhausted; while in issuing bonds no wasting asset is acquired—rather, a liability has been incurred which upon maturity will result in loss. Concededly that loss must be spread so far as it represents bond discount. We see no reason why the other element of that loss, bond commissions, should not be treated in the same way. Premiums on bonds issued prior to 1913 cannot be spread over the life of the bonds to enhance income. *Old Colony R.R. Co.* v. *Com'r*, 284 U.S. 552, 52 S.Ct. 211, 76 L.Ed. 484. This is because the premium was received prior to the sixteenth amendment and could not be affected by a subsequent taxing act; hence the amortization requirement of the Treasury Regulations were ineffective to declare it income for subsequent years. As applied to discount, the regulations raise no constitutional question; the loss is actually sustained after the sixteenth amendment became effective, and a requirement that it be amortized for purposes of deduction from gross income is entirely valid. Similarly as to commissions, which like discount are paid out of the new capital acquired by the issuance of bonds and do not result in actual loss until the bonds are paid.

Accordingly, the decision as to bond commissions is reversed, and the cause is remanded to the Board of Tax Appeals for further proceedings in harmony with this opinion.

United States Circuit Court of Appeals, Second Circuit

At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the court rooms in the Post-Office Building in the city of New York, on the 20th day of February one thousand nine hundred and thirty-four.

Present: Hon. Learned Hand, Hon. Thomas W. Swan, Hon. Augustus N. Hand, circuit judges.

UNION PACIFIC RAILROAD COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged and decreed that the order of said United States Board of Tax Appeals be and it hereby is reversed as to bond commissions and cause remanded for further proceedings in accordance with the opinion of this court.

It is further ordered that a mandate issue to the said Board in accordance with this decree.

WM. PARKIN, *Clerk.*

United States Circuit Court of Appeals, Second Circuit

UNION PACIFIC RAILROAD COMPANY

v.

COMMISSIONER OF INTERNAL REVENUE

Order for mandate

United States Circuit Court of Appeals, Second Circuit. Filed Feb. 20, 1934. William Parkin, clerk.

United States Circuit Court of Appeals for the Second Circuit

Petition filed February 28, 1934. Decided March 7, 1934

UNION PACIFIC RAILROAD COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Before L. Hand, Swan, and Augustus N. Hand, circuit judges.

On petition for rehearing

Henry W. Clark, of New York City, for petitioner.

PER CURIAM.

The taxpayer has petitioned for a rehearing as to the deduction of a loss incurred on the exchange of Navigation Company bonds in 1921. The Board held that the petitioner had not sustained the burden of proof that the Navigation Company bonds were held for investment. The petitioner complains that our opinion goes beyond an affirmance of this finding as to burden of proof and makes an

affirmative finding of fact that the Navigation bonds were held for investment. Our discussion of this subject closed with the sentence: "We conclude, therefore, that the Navigation bonds were held by Union Pacific for investment; hence no loss can be 'recognized' on the exchange." It was not our purpose to make any modification in the fact findings of the Board. Consequently our opinion will be modified by deleting the above-quoted sentence and substituting therefor the following: "We conclude, therefore, that the Board correctly held that the petitioner had not sustained the burden of proving that the Navigation bonds were not held by it for investment, hence no loss can be 'recognized' on the exchange."

The petition for rehearing is denied.

United States Circuit Court of Appeals, Second Circuit

At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the court rooms in the Post Office Building in the city of New York, on the 14th day of March, one thousand nine hundred and thirty-four.

Present: Hon. Learned Hand, Hon. Thomas W. Swan, Hon. Augustus N. Hand, circuit judges.

UNION PACIFIC RAILROAD COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

A petition for a rehearing having been filed herein by counsel for the petitioner, upon consideration thereof it is ordered that said petition be and hereby it denied.

WM. PARKIN, *Clerk.*

United States Circuit Court of Appeals, Second Circuit

UNION PACIFIC RAILROAD COMPANY

v.

COMMISSIONER OF INTERNAL REVENUE

order

United States Circuit Court of Appeals, Second Circuit. Filed Mar. 14, 1934. William Parkin, clerk.

UNITED STATES OF AMERICA

Southern District of New York

I, William Parkin, clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 130, inclusive, contain a true and

complete transcript of the record and proceedings had in said court, in the case of *Union Pacific Railroad Company, petitioner*, against *Commissioner of Internal Revenue, respondent*, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said court to be hereunto affixed, at the city of New York, in the Southern District of New York, in the Second Circuit, this 7th day of April, in the year of our Lord one thousand nine hundred and thirty-four, and of the independence of the said United States the one hundred and fifty-eighth.

[SEAL.] WM. PARKIN, *Clerk.*

U. S. GOVERNMENT PRINTING OFFICE: 1934

Order allowing certiorari

Filed October 8, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

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